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LEADERSHIP

February 14, 2023
Report 2022-110R

FACT SHEET

GRANT PARKS *California State Auditor*

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Charter School Facility Grant Program and Conduit Financing Program

The Programs Are Generally Achieving Their Purpose of Increasing Charter Schools' Access to Facility Funding

Background

The Facility Grant Program provides state funding to subsidize charter schools' facilities rent and lease costs at schools that enroll a sizeable percentage of students from low-income households. The Conduit Financing Program enables charter schools or entities working with them to obtain privately provided long-term financing for property acquisition and improvement. Some stakeholders were concerned that these two programs may be improperly benefiting some charter schools.

Key Findings

- Among the charter schools and their closely associated entities that we reviewed, we found that each entity had acted in alignment with each program's requirements in state law.
- The Legislature could adopt safeguards to better ensure that when a charter school whose facilities have had significant benefit from Facility Grant Program funds closes and is sold or leased that the facilities continue to be used for public education.
- The California School Finance Authority (CSFA) generally administers both programs in accordance with the state laws that created them, but it could improve its regulations and processes to ensure that rent and lease agreements are free from conflicts of interest and that applicants are not operating as or by for-profit organizations.

Key Recommendations

The Legislature should amend state law for the following purposes:

- Define the admissions priority that charter schools must give students from low-income areas to be eligible for Facility Grant Program funding and require the Office of the Attorney General to approve the sale or lease of a charter school facility if it benefited significantly from Facility Grant Program funds and paid rent to a closely associated entity.
- Clearly define the organizational types of charter schools and require them to respond to the California Department of Education's annual survey.

CSFA should do the following:

- Amend the definition of a related party in its regulations to include nonprofit CMOs and the subsidiaries of nonprofit charter schools and CMOs.
- Annually review a sample of applications to determine whether charter schools correctly reported that their lessors were not related.
- Require Facility Grant Program applicants to provide documentation that they are not operating as or by a for-profit organization and verify an applicant's compliance with this requirement.

The Facility Grant Program Provides Three Key Benefits to Charter Schools and Their Students

Makes More Funding Available for Students

Charter schools that receive Facility Grant Program funding rely less on other funding sources—such as state educational funding—to pay for their facility costs.

Correlates With Fewer Closures

The closure rate among Facility Grant Program recipients during our audit period was just over half that of other charter schools in California.

Addresses Classroom Space Needs

Twelve of the 19 Facility Grant Program recipients we reviewed were operating in areas where the State has identified a need for more classroom space.

Charter School Facility Grant Program and Conduit Financing Program

The Programs Are Generally Achieving Their Purpose of Increasing Charter Schools' Access to Facility Funding

February 2023

REPORT 2022-110R

Notice of Reissued Audit Report on June 16, 2023

Following the publication of our original report on February 14, 2023, we identified immaterial numerical inaccuracies, which we have corrected in this reissued report. None of these adjustments change the conclusions and recommendations presented in our original report. The corrections are as follows:

- The number of Facility Grant Program recipients that we reviewed for a comparison to Office of Public School Construction (OPSC) data has been **changed from 20 recipients to 19 recipients**. This change appears on pages 13, 17, 19, 40, and as a new footnote on page 45.
- The percentage of Facility Grant Program recipients we reviewed that were located in areas where OPSC data indicated classroom space was needed has been **changed from 60 percent to 63 percent**. This change appears on pages 13 and 19.
- The average number of Facility Grant Program recipients per year has been **changed from 424 to 421**. This change appears on page 13.
- The total number of Facility Grant Program recipients has been adjusted for two fiscal years. The total qualifying based on the enrollment of a nearby school in fiscal year 2017-18 has been **changed from 86 to 85**. The total qualifying in fiscal year 2019-20 based on their own enrollment has been **changed from 360 to 351**. The total qualifying in that same fiscal year based on the enrollment of a nearby school has been **changed from 77 to 76**. These changes appear on page 14.
- The lower end of the range of average amount of funding received annually has **changed from $312 ,000 to $319,000**. This change appears on page 17.
- The total number of schools receiving Facility Grant Program funds during our audit period has **changed from 507 to 505**. This change appears on pages 18 and 23.
- The total number of schools that did not receive Facility Grant Program funds during our audit period has **changed from 962 to 964**. This change appears on page 18.
- The total number of schools benefiting from both the Facility Grant Program and the Conduit Financing Program has **changed from 69 to 70**. This change appears on page 23.
- The total number of Facility Grant Program recipients reporting an unclear organizational type such as *other or none*, in response to the California Department of Education's survey of charter schools has **changed from 151 to 150**. This change appears on page 35.
- The total number of applicants we reviewed that reported not having related party agreements has been **changed from 10 to 11**. This change appears on page 39.

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February 14, 2023
2022-110R

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As directed by the Joint Legislative Audit Committee, my office conducted an audit of the California School Finance Authority (CSFA). Our assessment focused on the Charter School Facility Grant Program (Facility Grant Program) and the Conduit Financing Program, both of which CSFA administers. We determined that both the Facility Grant Program and Conduit Financing Program are generally achieving their purpose of increasing charter schools' access to facility funding.

The Facility Grant Program provides state funding to subsidize charter schools' facilities rent and lease costs and most of the recipient schools enroll a sizeable percentage of students from low-income households. We found that charter schools that received program funding closed less often than other charter schools, and the schools we selected for review were often located in areas needing additional classroom space. The Conduit Financing Program enables charter schools or entities working with them to obtain privately provided long-term financing for property acquisition and improvement. Despite stakeholder concerns that some charter schools may be improperly benefiting from the two programs, we found among the charter schools and their closely associated entities that we reviewed that each entity had acted in alignment with each program's requirements in state law. Although no part of the net earnings from the sale or lease of assets that are held by tax-exempt educational entities may benefit a private individual, charter school closures can still negatively affect students' education. Therefore, the Legislature could adopt safeguards to better ensure that when a charter school closes and its facilities that have benefited significantly from Facility Grant Program funds are sold or leased that they continue to be used for public education.

Finally, we found that CSFA generally administers both programs with fidelity to the state laws that created them, but it does not review all potential conflicts of interest when awarding Facility Grant Program funds. Moreover, CSFA could improve its processes so it does not rely on applicants to self-disclose related parties and to self-certify they are not operated as or by for-profit organizations.

Respectfully submitted,

GRANT PARKS
California State Auditor

Selected Abbreviations Used in This Report

CDE	California Department of Education
CMO	charter management organization
CSFA	California School Finance Authority
EMMA	Electronic Municipal Market Access
EMO	educational management organization
FPPC	Fair Political Practices Commission
FRPM	free or reduced-price meals
LLC	limited liability company
OPSC	Office of Public School Construction

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Summary

The Legislature enacted the Charter Schools Act of 1992 to allow the establishment of charter schools throughout the State. However, the act originally contained no provisions related to providing facilities for these schools. The State has since implemented a number of programs to help charter schools obtain or rent facilities in which to operate. For example, the California School Finance Authority (CSFA) administers the Charter School Facility Grant Program (Facility Grant Program), which provides state funding to charter schools to pay for a portion of their cost to rent or lease facilities. CSFA also administers the Conduit Financing Program, which enables charter schools to access funding from private investors for the purchase of facilities.

The Facility Grant Program Is Generally Fulfilling Its Purpose of Providing Support to Charter Schools That Serve Students From Low-Income Households

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The Legislature established the Facility Grant Program to provide financial support to charter schools that serve students from low-income areas. We found that, in alignment with the program's purpose, most charter schools that receive funding from it enroll at least 55 percent of their students from low-income households. In addition, some charter schools can receive Facility Grant Program funding if they are located near a qualifying elementary school and offer an admissions preference to nearby students. However, state law does not define the level of preference that charter schools must provide and, as a result, some schools' admissions policies could undermine the program's purpose. We also found that charter schools that received Facility Grant Program funding closed less often than other charter schools, and those we reviewed were often located in areas that the State has identified as needing additional classroom space.

Charter Schools' Benefiting From Both the Facility Grant Program and the Conduit Financing Program Does Not Violate State Law

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The Conduit Financing Program and the Facility Grant Program serve different purposes: the Conduit Financing Program enables charter schools or entities working with them to obtain privately provided long-term financing for property acquisition and improvement, while the Facility Grant Program provides public funding to assist certain charter schools in paying rent. Some stakeholders have raised concerns that charter schools or charter management organizations (CMOs) may be improperly benefiting from both programs. However, when we reviewed a selection of charter schools and CMOs that have benefited from both programs, we determined that those charter schools and CMOs had acted in alignment with the requirements in state law. Further, no part of the net earnings from the sale or lease of assets that are held

by tax-exempt educational entities—including charter schools—may benefit a private individual. Nonetheless, the Legislature could adopt safeguards to better ensure that facilities that have received Facility Grant Program funds continue to be used for public education when a school property is sold or leased.

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CSFA Does Not Take Adequate Steps to Appropriately Vet Facility Grant Program Applicants

After becoming responsible for administering the Facility Grant Program, CSFA established regulations in 2014 that exclude nonprofit CMOs and their subsidiary organizations from key conflict-of-interest provisions. We question this decision, given the potential for close relationships between charter schools and their CMOs or CMO subsidiaries: in particular, schools and nonprofit CMOs that share board members or other influential officials would not be related parties as defined by CSFA's regulations. Further, CSFA does not review all applicants to the Facility Grant Program for potential conflicts of interest; instead, it performs a detailed review only when applicants self-disclose a potential conflict. Similarly, CSFA relies on applicants self-certifying that they meet all program requirements to ensure that grant recipients are not operated as or by a for-profit organization. Because it does not take steps to verify that applicants' disclosures and certifications are correct, CSFA is less able to prevent a charter school from improperly receiving state funding under the Facility Grant Program.

Recommendations

The following are the recommendations we made as a result of our audit. Descriptions of the findings and conclusions that led to these recommendations can be found in the sections of this report.

Legislature

To ensure that students from low-income areas receive the maximum benefit from the Facility Grant Program, the Legislature should amend state law to define the admissions priority that charter schools must give students who either attend the nearest local public elementary school or reside in that public school's attendance area.

To mitigate the negative impact that charter school closures may have on students' education, the Legislature should amend state law to give the Office of the Attorney General the authority to approve, conditionally approve, or deny the sale or lease of a charter school facility if the charter school benefited significantly from Facility Grant Program funds and paid rent to a closely associated entity. To facilitate this authority, the law should include a means by which the Attorney General would receive notification about such sale or lease agreements. For example, the Legislature could require the organization that owns the facility to notify the Attorney General.

To enable CSFA to provide increased oversight of charter schools that received Facility Grant Program funds, the Legislature should clearly define the organizational types of charter schools and require charter schools to respond to the California Department of Education's annual survey.

California School Finance Authority

To better identify potential conflicts of interest involving the use of Facility Grant Program funding, CSFA should amend the definition of a *related party* in its regulations to include nonprofit CMOs and the subsidiaries of nonprofit charter schools and CMOs. In addition, CSFA should work with the Fair Political Practices Commission to ensure that its regulations address all conflict-of-interest laws, including Government Code section 1090 and the Political Reform Act of 1974.

To ensure that charter schools are appropriately disclosing information about related parties as part of the Facility Grant Program application process, CSFA should annually review a sample of applications to determine whether charter schools correctly reported that their lessors were not related.

To ensure that applicants meet a key program eligibility requirement, CSFA should require Facility Grant Program applicants to provide documentation that they are not operating as or by a for-profit organization. It should also adopt and begin following procedures to verify an applicant's compliance with this requirement.

Agency Response

CSFA indicated that it is committed to implementing our recommendations to the best of its ability given its available resources. We provide further comments on CSFA's response at the end of the report.

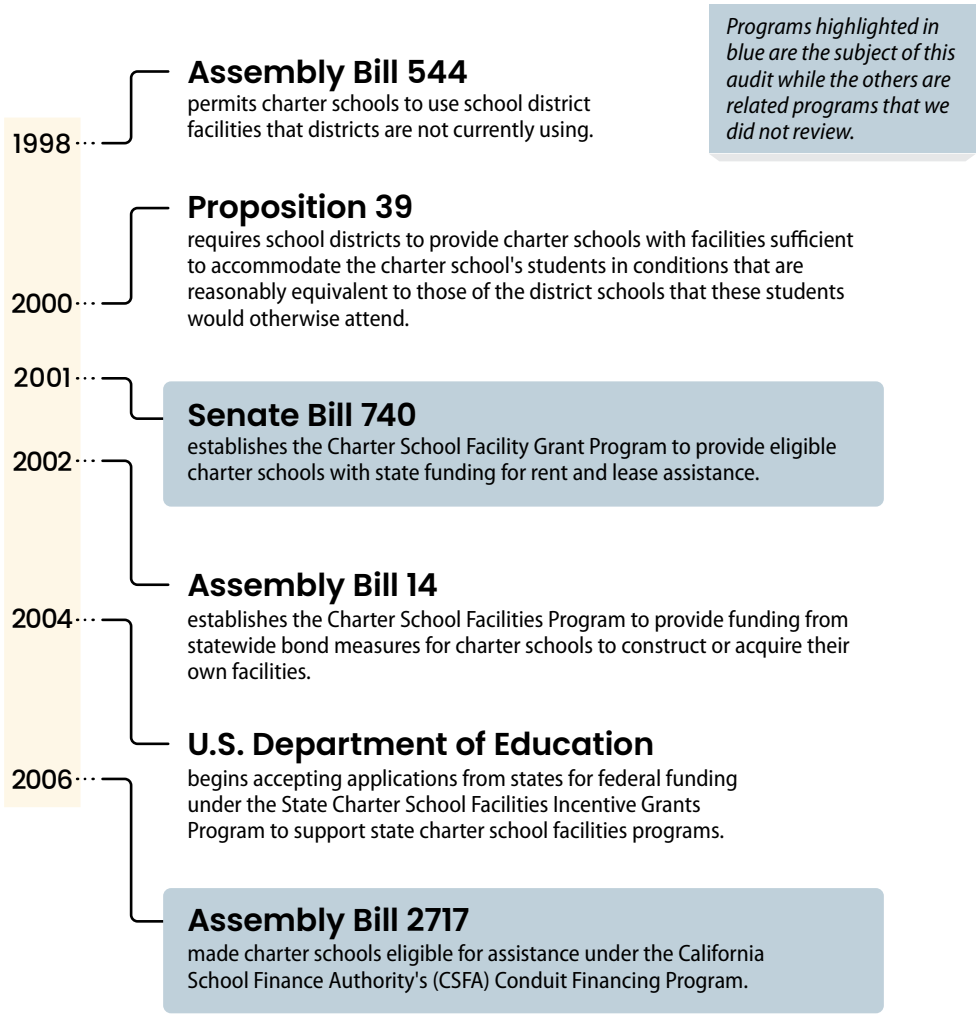
Introduction

Background

The Charter Schools Act of 1992 (Charter Schools Act) allows teachers, parents, students, and community members to establish and maintain schools that operate independently of existing school district structures. The Legislature intended the Charter Schools Act to serve a number of critical purposes. These include increasing learning opportunities for students in general and academically low-achieving students in particular, in part by providing parents and students with expanded choices in the types of educational opportunities that are available within the public school system. Local school district governing boards or county boards of education can grant charters to charter schools. These detail the charter schools' specific goals and other planned operations. Since July 2019, state law has prohibited new charter schools and those seeking charter renewal or revision from either operating as, or being operated by, for-profit corporations, for-profit educational management organizations (EMOs), or for-profit charter management organizations. In fiscal year 2021–22, California had nearly 1,300 charter schools serving about 677,000 students in kindergarten through 12th grade—about 11 percent of the State's 5.9 million students.

The Charter Schools Act originally contained no provisions for providing facilities. Since the act's origination, state policies related to charter school facilities have developed in a piecemeal manner. Figure 1 shows several programs and enacted laws that provided facility assistance to charter schools. One significant change occurred in 2000 when voters approved Proposition 39, which declared the intent of the people that public school facilities should be shared fairly among all public school students, including those attending charter schools. Proposition 39 requires school districts to make facility space available to a qualifying charter school operating in their district. Specifically, districts are required to provide facilities that are sufficient to accommodate all of the charter school's in-district students and that are reasonably equivalent to the facilities in which those students would be accommodated if they attended another public school in the district. According to a March 2019 presentation by the Legislative Analyst's Office, about half of charter schools occupy facilities provided by their authorizing school district. State law allows school districts that make facility space available to charter schools to charge the charter school a pro rata share of certain facilities costs but prohibits the district from otherwise charging the charter school for the facility space.

Figure 1
Timeline of Charter School Facility Legislation and Programs


Programs highlighted in blue are the subject of this audit while the others are related programs that we did not review.
1998
Assembly Bill 544
permits charter schools to use school district facilities that districts are not currently using.
2000
Proposition 39
requires school districts to provide charter schools with facilities sufficient to accommodate the charter school's students in conditions that are reasonably equivalent to those of the district schools that these students would otherwise attend.
2001
Senate Bill 740
establishes the Charter School Facility Grant Program to provide eligible charter schools with state funding for rent and lease assistance.
2002
Assembly Bill 14
establishes the Charter School Facilities Program to provide funding from statewide bond measures for charter schools to construct or acquire their own facilities.
2004
U.S. Department of Education
begins accepting applications from states for federal funding under the State Charter School Facilities Incentive Grants Program to support state charter school facilities programs.
2006
Assembly Bill 2717
made charter schools eligible for assistance under the California School Finance Authority's (CSFA) Conduit Financing Program.

Source: State law, federal guidance, and CSFA information.

According to the same Legislative Analyst's Office presentation, most remaining charter schools occupy privately leased facilities while a few own their school facilities. As we later discuss, the State operates programs that provide funding to subsidize charter schools' rent or lease costs and that provide a means for the charter schools to borrow funds from private entities to procure or update facilities. That said, charter schools have received only a small fraction of the overall funding for school facilities derived from statewide school facilities bonds. Specifically, since 1998 the State has issued about $42 billion in general obligation bonds for school facility construction or modernization. Of that amount, only about $1.4 billion, or 3 percent, was accessible to charter schools.

Charter Schools and the Subsidiary Organizations That Support Them

Charter schools and the organizations that exist to support them may organize themselves in a myriad of ways. According to Ed-Data, charter schools are usually created and run by teachers, parents, community-based groups, or charter management organizations (CMOs) that manage more than one charter school.[1]

Charter schools themselves are primarily concerned with the management and operation of school-related activities, the most prominent being the instruction of students. Consequently, charter schools may form one or more subsidiary organizations to support other aspects of their operations. For example, some charter schools may form subsidiary organizations for the purpose of managing property. Similarly, a CMO may establish subsidiaries to support the CMO and its charter schools. For instance, a CMO may form a subsidiary nonprofit organization to support its facilities and manage all facility planning and development. Once formed, these subsidiary organizations are separate legal entities from the parent organization that created them, though their activities may be reflected on the parent organization's tax return.

Additionally, charter schools, CMOs, or their subsidiaries may form a title-holding entity, such as a limited liability company (LLC). Some of these entities are formed for the exclusive purpose of holding title to property, collecting rental income, and turning over the income to the charter school, the CMO, or a subsidiary of the charter school or CMO. Holding title in a separate entity limits liability associated with the property and may enhance overall access to financing. Figure 2 shows three examples of charter school organizational structures. For the purposes of this audit, we will refer to all charter school and CMO subsidiary organizations as *subsidiaries*.

According to the California Department of Education (CDE), the largest source of revenue for most charter schools is the State's local control funding formula—the primary source of local educational agencies' general purpose funding. The State provides funding through the local control funding formula based largely on a district's or school's average daily attendance and the grades it serves. A charter school generally may use its local control funding formula allocation for its operations, including any rent or lease costs it may incur.[2]

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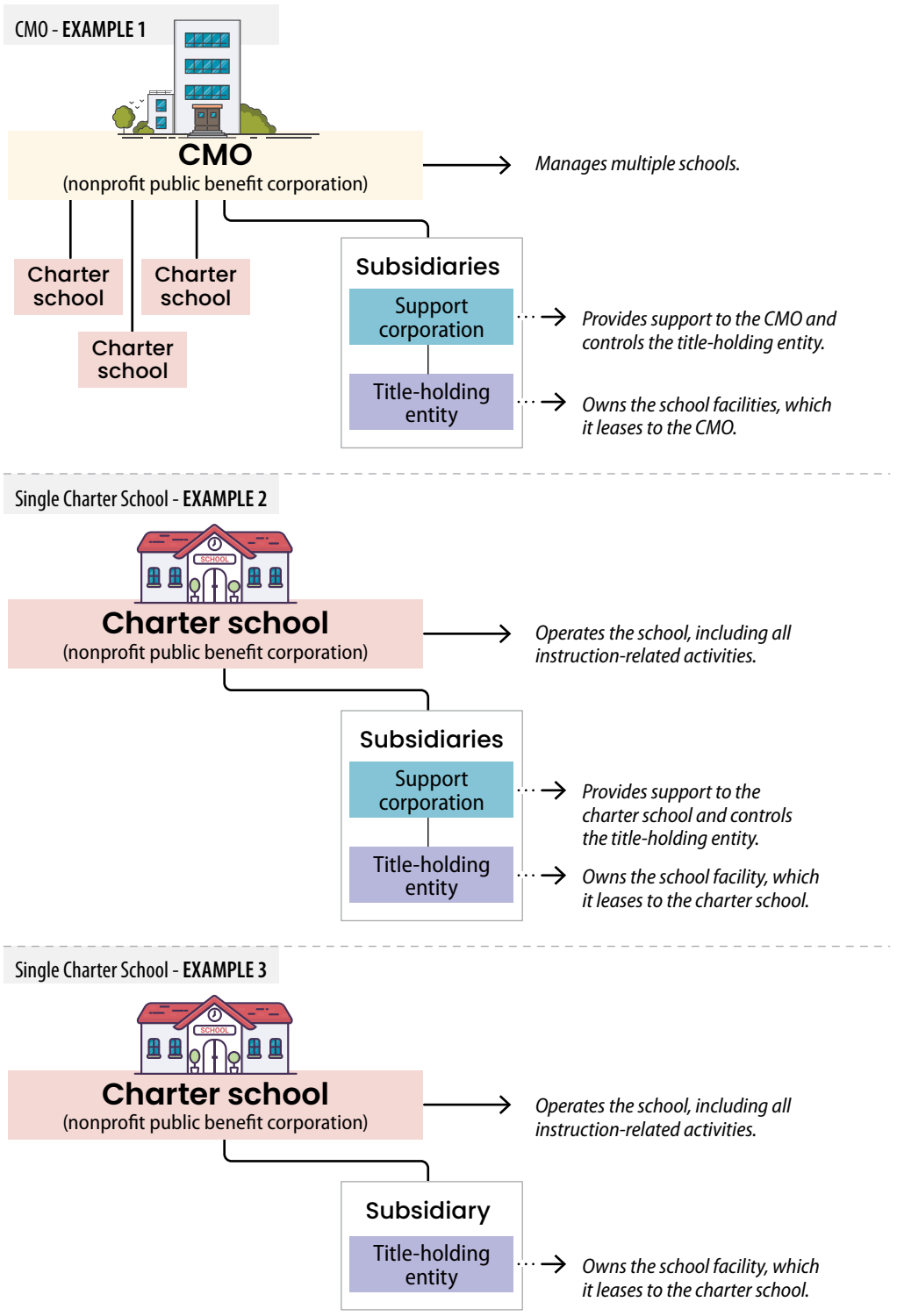
1 Ed-Data is a partnership of CDE, EdSource, and the Fiscal Crisis and Management Assistance Team. It offers the Legislature, policymakers, educators, parents, and the public access to data about K-12 education in California.

2 Throughout this report we use the term *operational funding* to refer to the local control funding formula allocation for operations.

Figure 2
Three Examples of Organizational Structures That Charter Schools and CMOs May Adopt


CMO - EXAMPLE 1
CMO
(nonprofit public benefit corporation)
Manages multiple schools.
Charter school
Charter school
Charter school
Subsidiaries
Support corporation
Provides support to the CMO and controls the title-holding entity.
Title-holding entity
Owns the school facilities, which it leases to the CMO.
Single Charter School - EXAMPLE 2
Charter school
(nonprofit public benefit corporation)
Operates the school, including all instruction-related activities.
Subsidiaries
Support corporation
Provides support to the charter school and controls the title-holding entity.
Title-holding entity
Owns the school facility, which it leases to the charter school.
Single Charter School - EXAMPLE 3
Charter school
(nonprofit public benefit corporation)
Operates the school, including all instruction-related activities.
Subsidiary
Title-holding entity
Owns the school facility, which it leases to the charter school.

Source: Charter school tax and incorporation documents, bond documentation, and applications for Facility Grant Program funds.

Charter School Facility Grant Program

The Facility Grant Program was enacted by the Legislature in 2001 to provide state funding to charter schools to pay for a portion of their cost to rent or lease facilities. In the first three years of the program's existence, the Legislature appropriated to it a total of $27.7 million. The Legislature has since increased the program's annual appropriation several times. In the five most recent fiscal years, the average annual appropriation to the program was about $130 million. Over fiscal years 2017–18 through 2021–22, CSFA awarded a total of about $685 million under the Facility Grant Program. The four charter schools we list in Table 1 account for roughly 5 percent of the total amount awarded during the period.

Table 1
Charter Schools That Received the Most Funding From the Facility Grant Program From Fiscal Years 2017–18 Through 2021–22

CHARTER SCHOOL NAME	TOTAL AMOUNT FROM THE FACILITY GRANT PROGRAM
Palmdale Aerospace Academy	$10,992,000
Wonderful College Prep Academy	9,087,000
Orange County School of the Arts (OCSA)	8,631,000
Fortune Charter	7,752,000

Source: CSFA records on the Facility Grant Program.

CDE was originally responsible for administering the Facility Grant Program. However, the Legislature later amended state law to transfer this responsibility and, in fiscal year 2013–14, CSFA became the program administrator. State law established CSFA in 1986 to finance educational facilities and give school districts access to funds to pay for maintenance and operating expenses connected to the ownership or operation of an educational facility. Housed within the State Treasurer's Office, CSFA is composed of a three-member board, with the state treasurer serving as chair and the superintendent of public instruction and the director of the Department of Finance serving as the remaining members.

Although the criteria for program eligibility have changed over time, the focus of the Facility Grant Program has remained consistent since its earliest years: to assist charter schools that are located in low-income areas with facility rent and lease costs. To achieve that purpose, state law uses eligibility for free or reduced-price meals (FRPM) as the standard for determining whether a student's household is low income. The text box summarizes the key criteria for program participation that relate to FRPM.

The Facility Grant Program's Key Criteria Related to FRPM

To meet the Facility Grant Program's FRPM-related criteria, a charter school site can either:

- Be physically located in the attendance area of a public elementary school in which at least 55 percent of the enrolled students are eligible for FRPM.

-AND-

- Give a preference in admissions to students who are enrolled in that public elementary school and who live in the attendance area of that school.

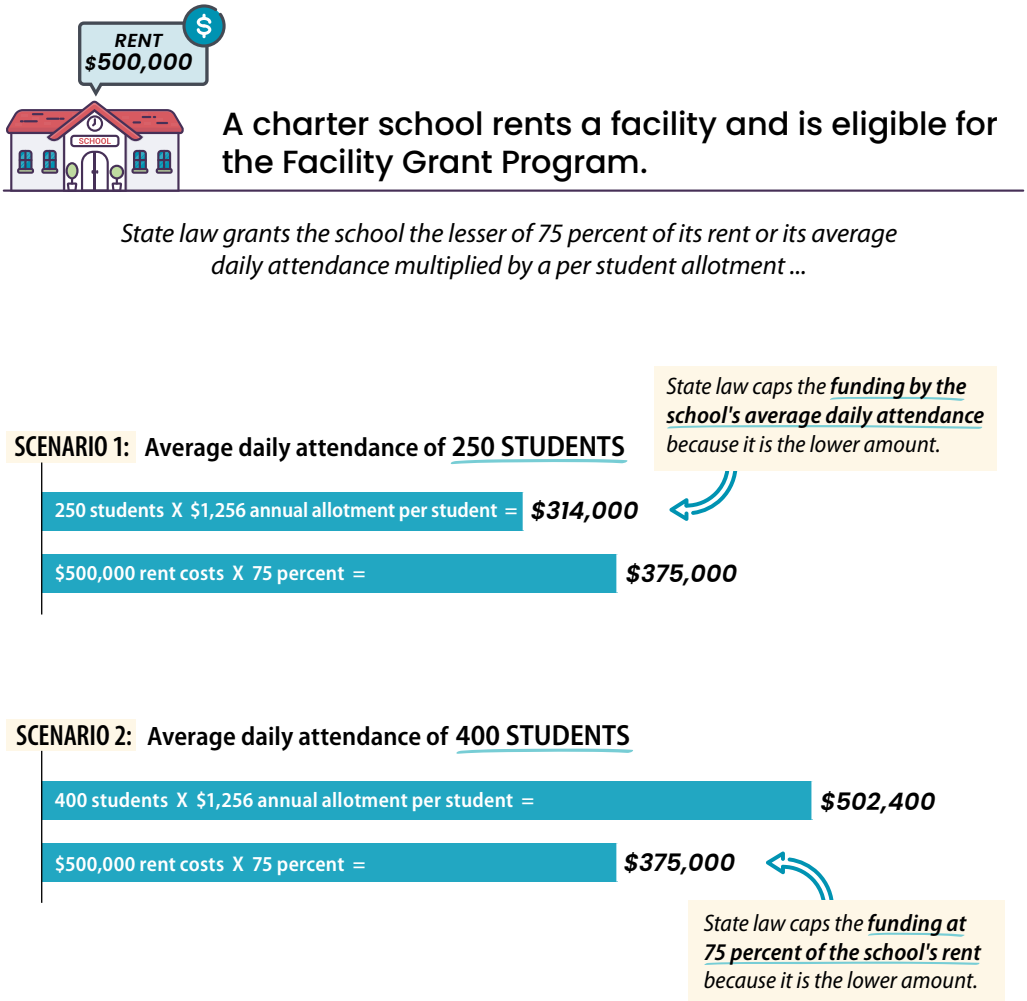
-OR-

- Enroll at least 55 percent FRPM-eligible students.

Source: State law.

State law establishes several rules related to the amount of Facility Grant Program funding a charter school can receive. As Figure 3 depicts, state law places caps on program payments. Moreover, state law requires that the rent or lease costs in a new agreement must be at or below the market rate based on an independent appraisal. For existing agreements, state law caps the rate of increase over the prior year's costs by a cost-of-living adjustment. This requirement protects against rapid increases in the amount payable by the program. Finally, CSFA may not provide funds to charter schools if they occupy space within existing school district or county office of education facilities or if they receive reasonably equivalent facilities under the provisions of Proposition 39.

Figure 3
State Law Caps Each Charter School's Facility Grant Program Payments


RENT
$500,000
SCHOOL
A charter school rents a facility and is eligible for the Facility Grant Program.
State law grants the school the lesser of 75 percent of its rent or its average daily attendance multiplied by a per student allotment ...
SCENARIO 1: Average daily attendance of 250 STUDENTS
250 students X $1,256 annual allotment per student = $314,000
$500,000 rent costs X 75 percent = $375,000
State law caps the funding by the school's average daily attendance because it is the lower amount.
SCENARIO 2: Average daily attendance of 400 STUDENTS
400 students X $1,256 annual allotment per student = $502,400
$500,000 rent costs X 75 percent = $375,000
State law caps the funding at 75 percent of the school's rent because it is the lower amount.

Source: Analysis of state law.

To further protect the distribution of Facility Grant Program funds, CSFA regulations require that charter schools that receive the funds comply with a set of standards. For example, mirroring the requirement in state law we describe earlier, the regulations specify that charter schools cannot operate as or be operated by a for-profit organization. Further, charter schools must be in good standing with their chartering authority. Additionally, CSFA's program regulations generally prohibit charter schools from using Facility Grant Program funding to make any lease or rent payments to a lessor that is related to the school or any of its board members, employees, or officers. However, as we describe later, CSFA exempts certain types of entities from this prohibition.

Conduit Financing Program

Unlike the Facility Grant Program, the Conduit Financing Program does not provide state funding to charter schools. Rather, it enables charter schools and other entities that are working in conjunction with charter schools to have access to funding from private investors through the sale of revenue bonds to finance educational facility projects. Revenue bonds are a type of municipal bond that are generally repaid through the revenue generated by the activity that the bonds financed. CSFA is a conduit bond issuer and its revenue bonds are sold to private investors who agree to purchase the bonds on favorable terms, such as tax-free interest. The proceeds of the bond sale are then provided to the entity that sought the financing. Revenue bonds are distinguishable from general obligation bonds because taxpayers do not pay for revenue bonds, whereas tax revenue is a source of repayment of general obligation bonds. Consequently, the borrowers, such as charter schools, CMOs, or their subsidiaries—not the State—are responsible for the repayment of any revenue bonds that CSFA issues on their behalf.

CSFA has long been responsible for overseeing the statewide system of the sale of revenue bonds to provide financing to public school districts and community colleges. However, charter schools did not have the same access to financing through CSFA until after 2006, when the Legislature enacted a bill to include charter schools. According to the legislative analyses of that bill, charter schools had attempted to obtain facility financing secured by their regular state funding, but financial institutions were reluctant to offer financing to them because they must renew their charters every five years in order to maintain their state revenue stream.

CSFA's 2021 annual report indicates that since 2010 it had facilitated access to more than $2.7 billion in conduit financing across multiple financing instruments. For this audit, we were asked to focus on conduit revenue bonds CSFA issued on behalf of charter schools. From fiscal years 2017–18 through 2021–22, CSFA facilitated the issuance of 45 revenue bond transactions on behalf of entities supporting charter schools, for a total of more than $1 billion of private money. Table 2 lists the five entities and the number of associated charter schools that benefited the most from conduit revenue bonds the CSFA issued from fiscal years 2017–18 through 2021–22. Other conduit issuers, listed in the text box, also help charter schools in California access the financial markets. However, the

Other Conduit Revenue Bond Issuers in California

California Municipal Finance Authority

California Infrastructure and Economic Development Bank

California Enterprise Development Authority

California Public Finance Authority

Source: Electronic Municipal Market Access.

Electronic Municipal Market Access (EMMA) website indicates that, since fiscal year 2017–18, CSFA has facilitated the issuance of more conduit revenue bond transactions than all other issuers in California, accounting for 60 percent of all charter school revenue bond transactions during our audit period.

Table 2
Entities That Have Benefited the Most From Conduit Revenue Bonds the CSFA Issued From Fiscal Years 2017–18 Through 2021–22

ENTITY*	TOTAL AMOUNT OF CONDUIT REVENUE BONDS	NUMBER OF CHARTER SCHOOLS
KIPP Los Angeles Schools	$121,875,000	9
Aspire Public Schools	111,035,000	12
Granada Hills Charter High School	61,460,000	1
River Springs Charter School	60,125,000	1
Classical Academies	56,180,000	3

Source: Analysis of bond documents at EMMA.
* Entity means a CMO or a charter school.

CSFA has instituted several safeguards to reduce the risks that a charter school will provide inaccurate financial or legal information to obtain financing through conduit revenue bonds. Multiple parties, such as the bond counsel, the borrower's counsel, and CSFA's counsel (usually, the Office of the Attorney General [Attorney General]) review the bond offering documents. CSFA also requires charter schools to demonstrate financial feasibility before its board will approve a decision to issue conduit revenue bonds. Finally, CSFA has the public finance division within the State Treasurer's Office review and approve the bond purchase agreements, and the CSFA stated that the division is also involved in discussions with the bond purchasers.

Having several entities review and approve conduit revenue bond transactions reduces the risk of illegal or improper activity. Moreover, as we previously indicated, the State is not liable for repayment of debt arising from the Conduit Financing Program. Although independent credit rating entities can ultimately base the State's credit rating on whatever criteria or conditions they choose, we assess the risk that the State's credit rating will be significantly affected if a charter school defaults on its bond repayment to be low.

The Facility Grant Program Is Generally Fulfilling Its Purpose of Providing Support to Charter Schools That Serve Students From Low-Income Households

Key Points

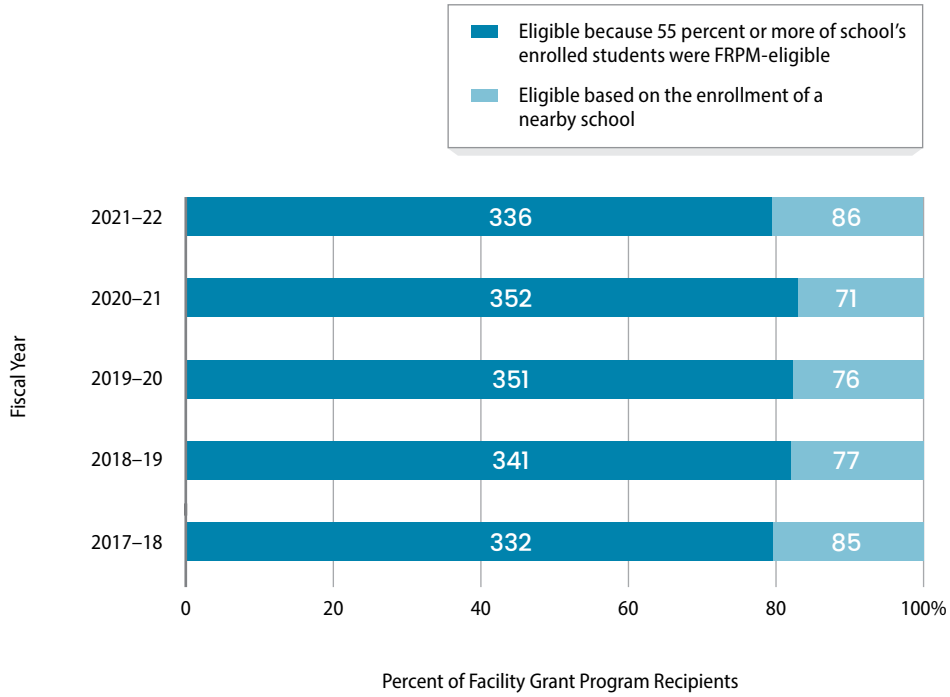
- Eighty percent of Facility Grant Program recipients are charter schools with at least 55 percent of their enrolled students coming from low-income households. Further, CSFA has established an adequate process to ensure that a school's FRPM enrollment meets the eligibility threshold.
- State law establishing the Facility Grant Program does not specify the level of admissions preference that charter schools must offer to students who live in the predominantly low-income areas in which the schools are located. As a result, some of the charter schools' admissions policies may not fully meet the program's purpose under state law.
- Charter schools that participate in the Facility Grant Program rely less on their operational allocations to pay for facility costs and closed less often than charter schools that did not participate. Additionally, among a selection of 19 Facility Grant Program recipients we reviewed, 63 percent were located in areas of the State that needed additional classroom space.

Most Charter Schools That Receive Facility Grant Program Funding Enroll a Sizeable Percentage of Students From Low-Income Households

Information on the students enrolled at the charter schools that receive Facility Grant Program funding demonstrates that the program is succeeding in supporting schools with students from low-income households. From fiscal years 2017–18 through 2021–22, CSFA issued Facility Grant Program funds to an average of 421 schools annually. As Figure 4 shows, roughly 80 percent of these schools met the threshold for eligibility based on their enrollment of FRPM-eligible students, meaning that at least 55 percent of their enrolled students were eligible for FRPM. The remaining 20 percent of schools qualified for funding because they were physically located near a noncharter public school with a high FRPM enrollment and because they offered a preference in admissions to students that either attended that public elementary school or lived in the attendance area of that school (nearby students).[3] In other words, the significant majority of charter schools that received Facility Grant Program funding did so on the basis of their own enrollment, not that of a nearby noncharter school. Enrollment across all schools that received program funding in the most recent fiscal year showed a similarly high percentage of students from low-income households. In fiscal year 2021–22, about 70 percent of the student population of all of the schools that received Facility Grant Program funds were FRPM-eligible.

[3] CSFA's application review tracking documents did not consistently demonstrate that CSFA had verified the admissions preferences for these charter schools throughout the whole five-year period we reviewed. We do not make a recommendation in this area because CSFA has documented its review in each of the three most recent years.

Figure 4
During Our Audit Period, Most Facility Grant Program Recipients Were Eligible for Funding Based on Their Own Enrollment



Source: CSFA's list of Facility Grant Program recipients from fiscal years 2017–18 through 2021–22.

Note: We display charter schools as eligible based first on their own enrollment. We display a charter school as eligible because of another public school's enrollment only if the charter school did not enroll sufficient FRPM-eligible students to be eligible on that basis. Some charter schools are likely eligible under both criteria.

The overall distribution of Facility Grant Program funding from fiscal years 2017–18 through 2021–22 also aligns with the data in Figure 4. During this period, CSFA awarded about $685 million in Facility Grant Program funds. Charter schools that were eligible for funding based on their own enrollment received 81 percent of this funding. CSFA awarded the remaining 19 percent to schools that were eligible because of their physical location and their admissions preference for nearby students.

CSFA is adequately reviewing FRPM enrollment to confirm that charter schools meet this key eligibility criterion. To verify that a charter school meets the FRPM requirements, CSFA uses annual enrollment data maintained by CDE. We reviewed a selection of six applications to the Facility Grant Program and found that in each case CSFA appropriately reviewed the application with respect to FRPM eligibility. If a charter school's own enrollment of FRPM-eligible students was below the 55 percent threshold or if it was a first-year charter school, CSFA verified whether the nearest

public noncharter elementary school met the 55 percent FRPM threshold.[4] In these cases, CSFA also verified whether the charter school gave preference in admission to nearby students.

Further, CSFA has appropriately denied funding to schools that did not meet the FRPM eligibility criteria. From fiscal years 2017–18 through 2021–22, CSFA determined that 109 applications did not meet eligibility criteria—around 5 percent of all applicants during the period. About 34 percent (37 out of 109) of these denied applications were ineligible because the charter schools did not meet the FRPM eligibility threshold. CSFA also identified that charter schools were ineligible because they were not in good standing with their charter authorizer, did not have eligible lease or rent costs, or did not have an approved or current charter.

State Law Does Not Specify the Degree to Which Charter Schools That Receive Facility Grant Program Funding Should Prioritize Admitting Nearby Students

As the previous section describes, about 20 percent of Facility Grant Program recipients have not been eligible for funding based on their own enrollment of FRPM-eligible students. When a charter school is not eligible based on its own enrollment, it can qualify for Facility Grant Program funding by meeting the criteria in the text box. However, the state law establishing the Facility Grant Program does not specify the priority of the preference in admissions that a charter school must provide to nearby students to be eligible for funding.

Portions of State Law Regarding Facility Grant Program Eligibility

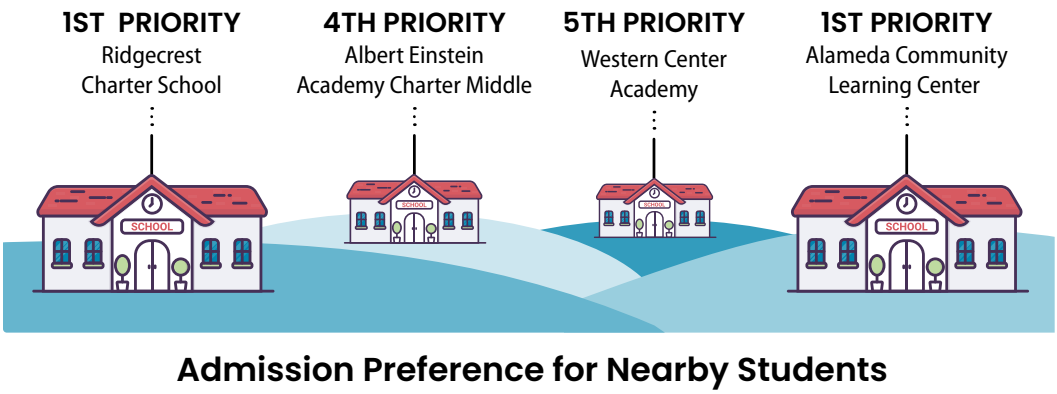
"A charter school site is eligible for funding ... if the charter school site ... is physically located in the attendance area of a public elementary school in which 55 percent or more of the pupil enrollment is eligible for free or reduced-price meals *and the charter school site gives a preference in admissions to pupils who are currently enrolled in that public elementary school and to pupils who reside in the elementary school attendance area where the charter school site is located* [emphasis added]."

Source: State law.

In the absence of precise direction, charter schools that receive Facility Grant Program funds have inconsistently prioritized the admission of nearby students. As Figure 5 shows, we reviewed four charter schools that received Facility Grant Program funding, and each established a different priority level for the admission of nearby students. In particular, Ridgecrest Charter School and Western Center Academy have adopted markedly different admissions preferences, yet both were eligible for funding under the Facility Grant Program.

[4] To further improve its FRPM review process, CSFA has proposed amending the Facility Grant Program regulations by adding a definition for attendance area. According to CSFA, it has proposed this change to further clarify how it determines which nearby public noncharter elementary school to reference when reviewing applications.

Figure 5
Charter Schools Provide Varying Levels of Admission Preference to Nearby Students



Source: Charter petitions of the schools listed.

The four schools' different admissions preferences are all allowable under state law. Separate from the law governing the Facility Grant Program, state law generally provides discretion to charter schools—with the approval of their chartering authority—to establish admissions preferences, provided that those preferences meet the criteria in the text box. That said, the law requires charter schools to admit any interested students and bars them from discouraging students from enrolling based on their academic performance. When the number of interested students exceeds a charter school's available seats, the school must use a public random drawing to determine which students will attend.

Requirements for Charter School Admissions Preferences

Preferences must ...

- Be approved by the chartering authority at a public hearing.
- Be consistent with federal law, the California Constitution, and state law.
- Not result in limited access for specified disadvantaged groups of students.
- Not require mandatory parental volunteer hours.

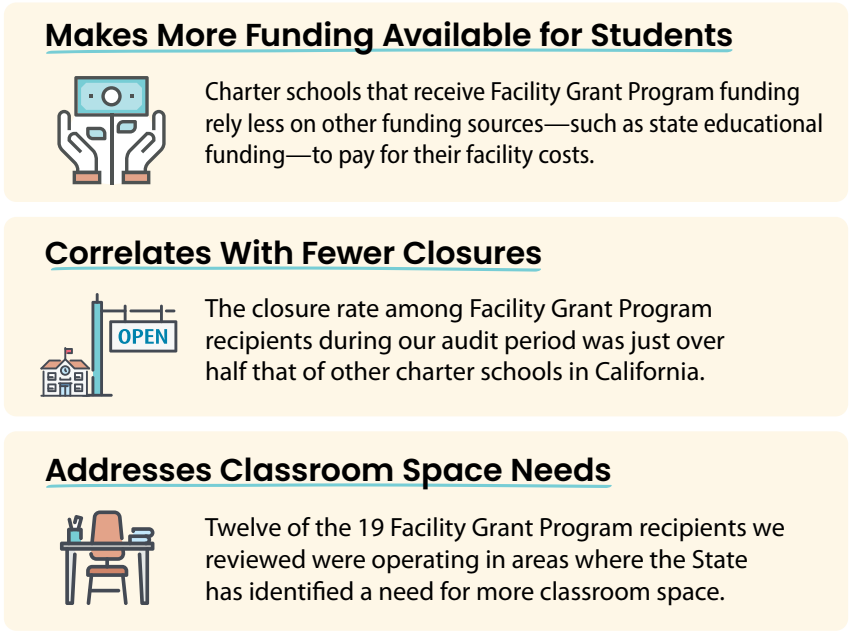
Source: State law.

Although admissions flexibility may make sense in the broader context of California's approach to charter schools, the statutory purpose of the Facility Grant Program is to provide facilities funding to schools that are located in low-income areas or that serve students from low-income families. Accordingly, the Legislature should consider defining the priority of the preference that charter schools must give to nearby students to be eligible for the Facility Grant Program. Under the current law, nearby students are not necessarily a highly preferred admission group, which could undermine the purpose of the program.

The Facility Grant Program Provides Important Benefits to Charter Schools and Their Students

Other data we reviewed further demonstrate that the Facility Grant Program is supporting charter schools and the students they serve in important ways. Specifically, we identified three key benefits that the program provides. Figure 6 summarizes these benefits.

Figure 6
The Facility Grant Program Provides Three Key Benefits to Charter Schools and Their Students


Makes More Funding Available for Students
Charter schools that receive Facility Grant Program funding rely less on other funding sources—such as state educational funding—to pay for their facility costs.
Correlates With Fewer Closures
OPEN
The closure rate among Facility Grant Program recipients during our audit period was just over half that of other charter schools in California.
Addresses Classroom Space Needs
Twelve of the 19 Facility Grant Program recipients we reviewed were operating in areas where the State has identified a need for more classroom space.

Source: Analysis of data from CSFA, CDE, Office of Public School Construction, and the Education Data Partnership.

Funding from the Facility Grant Program provided significant financial support to participating charter schools. From fiscal years 2017–18 through 2021–22, the average amount of funding each participating charter school received annually ranged from $319,000 to $336,000. Without the Facility Grant Program funding, these schools would have needed to use other funding sources—such as their operational allocations from the State—to pay for all of their facility costs. In effect, these schools would have seen a reduction in the amount of revenue available to spend on the direct education of students. As the text box shows, such a reduction might in some cases equal a substantive percentage of the operational funding a charter school receives from the State.

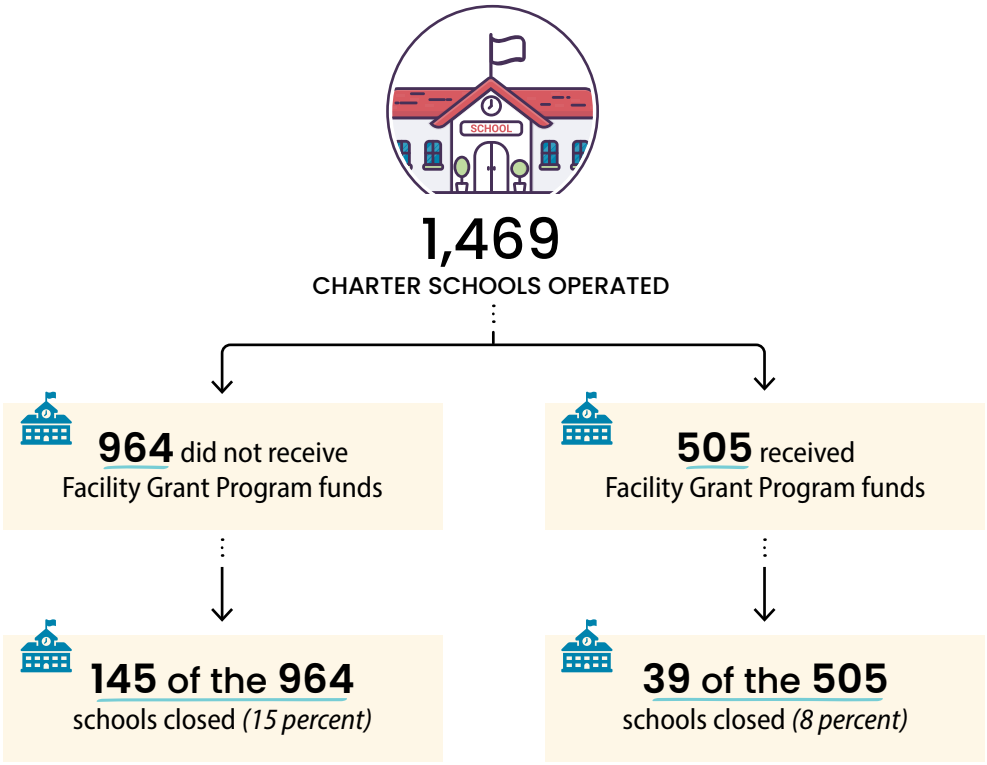
Facility Grant Program Funding Can Be Significant

- An eligible charter school that serves 450 elementary students may receive about $3.7 million annually from its state allocation.
- The same charter school could receive up to about $565,000 for facility rent and lease costs from the Facility Grant Program—the equivalent to about 15 percent of the charter school's state allocation.

Source: CDE's data on state funding of public education and CSFA's data on Facility Grant Program awards.

Participation in the Facility Grant Program also appears to be associated with charter school stability. When we reviewed charter school closures that occurred from fiscal years 2017–18 through 2021–22, we found that charter schools that did not receive Facility Grant Program funding were almost twice as likely to close as charter schools that received funding, as Figure 7 illustrates. School closures disrupt students' educations and may leave families scrambling to find new schools for their children to attend, sometimes during the school year. Using the average closure rate, we estimate that because of the Facility Grant Program, an average of 1,900 fewer charter school students experienced school closures each year during our audit period.

Figure 7
Over the Past Five Fiscal Years, Charter Schools Receiving Facility Grant Program Funds Closed Less Frequently Than Other Charter Schools


SCHOOL
1,469
CHARTER SCHOOLS OPERATED
964 did not receive Facility Grant Program funds
505 received Facility Grant Program funds
145 of the 964 schools closed (15 percent)
39 of the 505 schools closed (8 percent)

Source: CDE data on charter school closures and CSFA data on Facility Grant Program recipients from fiscal years 2017–18 through 2021–22.

Finally, the information we reviewed indicates that the Facility Grant Program supports charter schools in areas of the State that need additional classroom space, even though doing so is not an explicit goal of the program. When school districts apply for funding to construct new classroom space, they must submit data on existing classroom space to the Office of Public School Construction (OPSC) within the Department of General Services. However, because not all school districts have recently applied for this funding, OPSC does not have comprehensive and up-to-date

data on the need for additional classroom space throughout the State. Therefore, we could not perform a comprehensive review to determine the amount of Facility Grant Program funding that has gone to areas of the State that have adequate classroom space. Instead, we reviewed a selection of 19 Facility Grant Program recipients located in geographic areas for which OPSC data exist. We found that 63 percent—12 out of 19—were located in areas where OPSC had identified a need for additional classroom space. Our review therefore indicates that the Facility Grant Program is assisting the State in meeting classroom space needs that have been identified.

We did not identify any easily adoptable options for the State to implement restrictions on the Facility Grant Program to ensure that it provides funding only to charter schools that are located in areas that lack classroom space. As we state previously, OPSC's data on the need for classroom space is not comprehensive or uniformly up-to-date. Therefore, the State has no current reliable data source that it could use to impose, as a condition of eligibility for the Facility Grant Program, the requirement that schools be located in an area with a need for classroom space. Although the State could begin collecting data to implement such a requirement, school districts—and not charter schools—are likely the primary custodians of the information that OPSC needs to develop its needs assessments. Therefore, the burden of such a new requirement would fall on school districts and not the charter schools that apply for Facility Grant Program funding.

Furthermore, restricting Facility Grant Program funding to charter schools located only where classroom space is needed could eliminate the participation of schools that have until now been eligible because they enroll a high percentage of students from low-income households. Thus, this change could constrain the program's ability to target assistance to schools that serve students from low-income households or areas of the State—the program's primary purpose.

Please refer to the section on page 3 to find the recommendations that we have made as a result of these audit findings.

Charter Schools' Benefiting From Both the Facility Grant Program and the Conduit Financing Program Does Not Violate State Law

Key Points

- State law governing conflicts of interest does not categorically prohibit charter schools and CMOs from entering into rent or lease agreements with closely associated entities.
- Some stakeholders have expressed concern about charter schools benefiting from both the Conduit Financing Program and Facility Grant Program. However, when we reviewed a selection of cases in which charter schools benefited from both programs, we found each case aligned with the requirements in state law.
- Although no part of the net earnings from the sale of a facility that a tax-exempt educational entity owns may benefit a private individual, the Legislature could better ensure that facilities continue to be used for public education by amending state law to create safeguards when schools close.[5]

State Law Does Not Categorically Prohibit Charter Schools or CMOs From Entering Rent or Lease Agreements With Closely Associated Entities

Charter schools and CMOs can form subsidiary organizations, and—as we describe in the Introduction—may do that so the subsidiary can own or manage school facilities. If a charter school or CMO chooses to form a subsidiary that holds title to a facility, the subsidiary is the legal owner of the facility, not the charter school or CMO. In addition, charter schools or CMOs can generally enter into contracts, such as rental or lease agreements, with their subsidiaries. Although a close relationship between the parties to a rent or lease agreement can raise concerns about potential self-dealing or conflicts of interest, state law governing conflicts of interest does not categorically prohibit a charter school or CMO from renting or leasing a facility from a subsidiary. Instead, state law defines certain conditions under which such agreements are prohibited.

Determining the legality of all rental and lease agreements between charter schools or CMOs and their subsidiaries would require an examination of the management structures between the entities and of the specific circumstances of each agreement. As we describe later, we have concerns about how thoroughly CSFA is vetting Facility Grant Program applications for compliance with conflict-of-interest requirements. Nonetheless, state law governing the Facility Grant Program does not expressly prohibit charter schools and CMOs from entering into rental or lease agreements with closely associated entities and then using the program funding to pay for those agreements if the entities otherwise comply with the requirements in state law and regulations.

[5] For purposes of this report, we use the term *tax-exempt* to mean either an entity that has its own individual tax-exempt status or an entity that is disregarded because it is included as part of its parent nonprofit corporation's tax-exempt status.

Beyond the strict legality of such arrangements, some stakeholders have expressed concern that charter schools and CMOs that use Facility Grant Program funding to pay for rent and lease agreements with closely associated entities are subverting the legislative intent of the Facility Grant Program. These concerns originate from the perspective that when charter schools pay rent to closely associated entities, they are essentially paying rent to themselves; thus, they are effectively using Facility Grant Program funding to acquire property rather than to subsidize rent or lease costs. In 2014, nearly a year after it received responsibility for administering the Facility Grant Program, CSFA adopted permanent regulations for the program's implementation. During that regulatory process, CSFA received public comments that expressed concern that CMOs were using funding from the Facility Grant Program to pay debt service for property they purchased and argued that there was no indication that the Legislature intended for Facility Grant Program funds to be used for that purpose.

We found no evidence in statute or the relevant legislative analyses that accompanied changes to state law that clearly indicates whether the Legislature considered rent or lease agreements between closely associated entities when it created the Facility Grant Program. Therefore, it is unclear whether the use of Facility Grant Program funds to pay rent to closely associated entities is contrary to the intent of the law.

After considering the breadth of our audit findings and conclusions, including the benefits we describe earlier that the program provides to schools located in lower-income areas of the State, the safeguards regarding the use of the program, and the protections against private gain that we describe later in this report, we do not recommend a prohibition on charter schools paying rent to closely associated entities. CSFA data indicates that at least one-third of Facility Grant Program recipients are in a rent or lease agreement with a closely associated entity. Consequently, a change to the eligibility criteria could disrupt state support to a significant number of schools. A less disruptive option would be for the Legislature to adopt protections around the disposition or repurposing of charter school facilities, an area we describe in more detail later in this report.

Types of Educational Facility Projects Funded Through the Conduit Financing Program

- Acquisition
- Construction
- Expansion
- Remodeling
- Renovation
- Improvement
- Furniture and Equipment

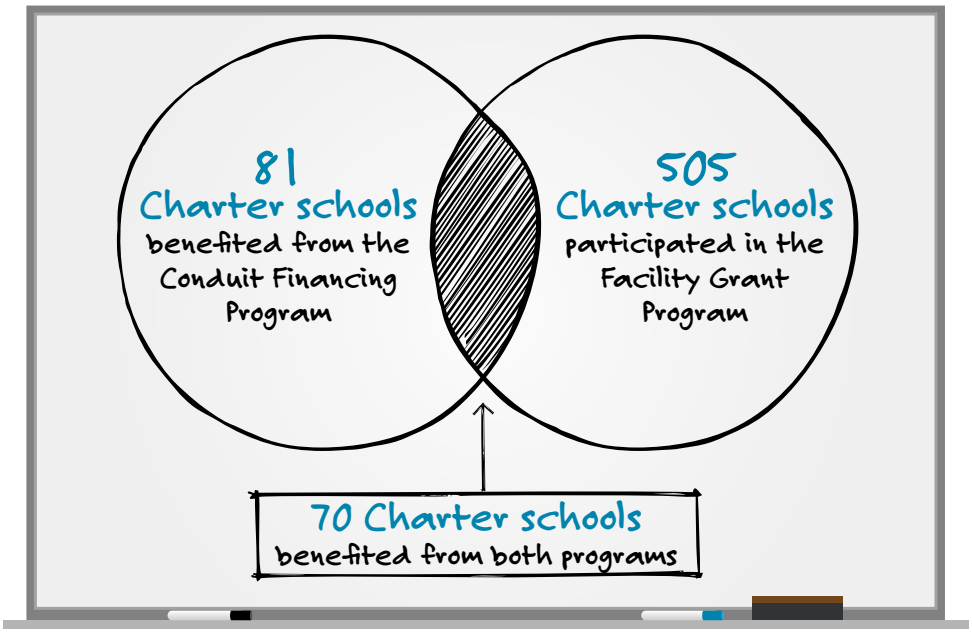
Source: State law.

Benefiting From Both the Conduit Financing Program and the Facility Grant Program Is Allowed Under State Law

In addition to receiving state funds through the Facility Grant Program, charter schools or entities working in conjunction with charter schools may use the Conduit Financing Program to access funding from private investors. State law authorizes CSFA to provide funds from private investors to charter schools and other entities that are working in conjunction with charter schools through the Conduit Financing Program so they can finance the types of educational facility projects the text box lists. Data from CSFA show that a large percentage of the entities that have participated in the Conduit Financing Program are closely associated with schools that received Facility Grant Program funding. Conversely, only 14 percent of the schools that received

Facility Grant Program funds were associated with an entity that participated in the Conduit Financing Program. Figure 8 displays the crossover between the programs during fiscal years 2017–18 through 2021–22.

Figure 8
During Our Audit Period, 70 Charter Schools Benefited From Both the Conduit Financing Program and the Facility Grant Program

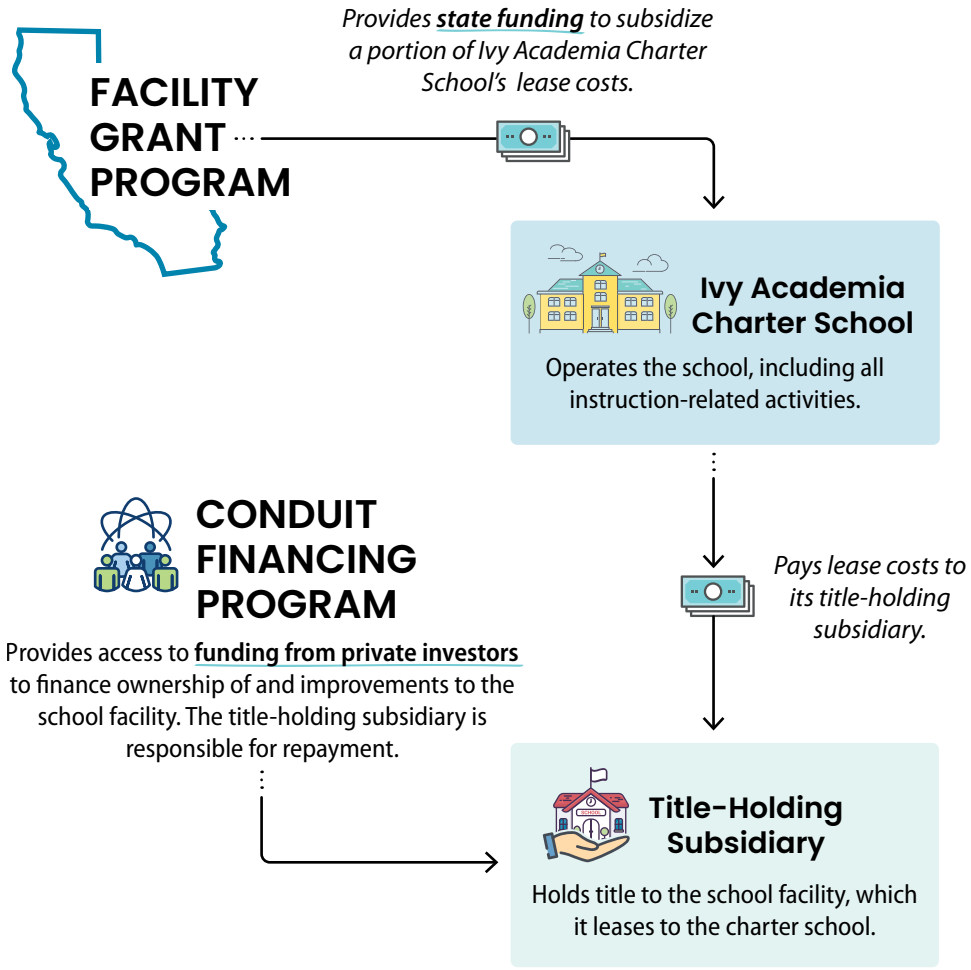


Source: CSFA's records related to both programs.

Some stakeholders have raised concerns that charter schools are acting inappropriately by benefiting from both programs. Specifically, some parties have argued that charter schools are using Facility Grant Program funds to pay debt incurred through the Conduit Financing Program. We reviewed these concerns by examining a selection of 10 cases in which a charter school and its associated entities participated in both the Facility Grant Program and the Conduit Financing Program during fiscal years 2017–18 through 2021–22. Five of these cases involved CMOs.

We found that all of the entities we reviewed appropriately financed educational facility projects with funding from the Conduit Financing Program. In one example, CSFA issued a subsidiary of a charter school—Ivy Academia—bond proceeds to refinance a property acquisition and construction project for its charter school facility. The subsidiary then leased the property to Ivy Academia. CSFA subsequently found that Ivy Academia met all eligibility requirements and awarded it Facility Grant Program funds to pay for lease costs to the subsidiary. Figure 9 depicts this scenario. We observed that the other nine entities established similar corporate structures to own property, and eight of them leased the property to a charter school that received funding under the Facility Grant Program.

Figure 9
A Charter School Can Appropriately Benefit From Both Conduit Revenue Bonds and Facility Grant Program Funds

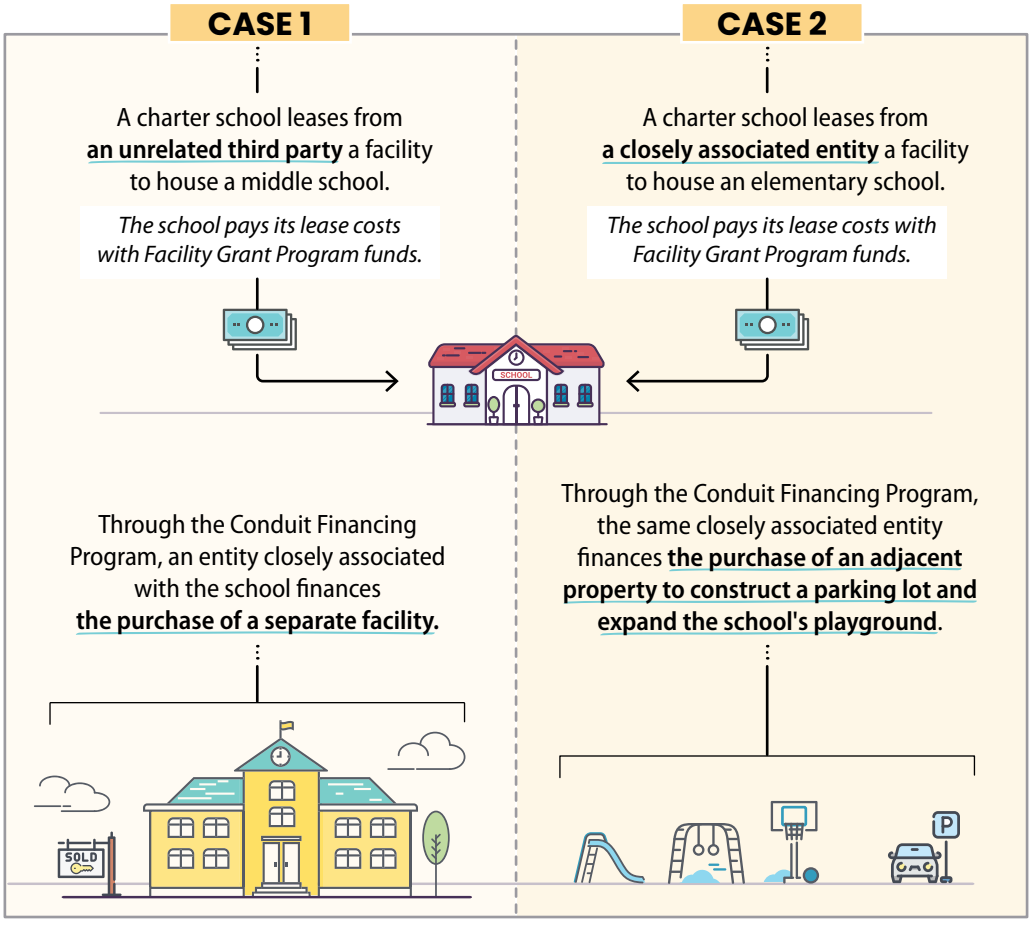

FACILITY GRANT PROGRAM
Provides state funding to subsidize a portion of Ivy Academia Charter School's lease costs.
Ivy Academia Charter School
Operates the school, including all instruction-related activities.
Pays lease costs to its title-holding subsidiary.
CONDUIT FINANCING PROGRAM
Provides access to funding from private investors to finance ownership of and improvements to the school facility. The title-holding subsidiary is responsible for repayment.
Title-Holding Subsidiary
Holds title to the school facility, which it leases to the charter school.

Source: State and federal law and CSFA's records related to both programs.

As we explain in the previous section, the state law that established the Facility Grant Program does not expressly prohibit charter schools from using program funding to pay for rent or lease agreements with closely associated entities. The same state law is also silent with regard to what a landlord may choose to do with the proceeds of a rent or lease agreement that a charter school is paying with Facility Grant Program funding. In other words, that law does not restrict charter schools that are participating in the Facility Grant Program from paying rent to a landlord that eventually uses that rent to service debt. The state law that establishes the Conduit Financing Program also does not prohibit the entities that receive proceeds from the program from using Facility Grant Program funding to pay off the bond debt. Therefore, we identified no violation of state law in the 10 cases we reviewed.

Further, we found that entities benefiting from both programs were not always directing funds from both programs to the same property. For example, as Figure 10 shows, we found instances in which a subsidiary organization financed the purchase of property for associated schools through the Conduit Financing Program while those schools simultaneously used Facility Grant Program funds to pay lease costs for a separate property to an unrelated third party. Similarly, a closely associated entity used the Conduit Financing Program to acquire property to construct a parking lot and to expand one of its school's playgrounds while the school simultaneously used Facility Grant Program funds to pay lease costs for an adjacent property that the school leased. These examples show that when a charter school and its closely associated entities participate in both the Facility Grant Program and the Conduit Financing Program, the charter school is not necessarily using Facility Grant Program funding to pay rent toward a debt that a closely associated entity incurred through the Conduit Financing Program.

Figure 10
A Charter School and Its Closely Associated Entities May Use the Facility Grant Program and the Conduit Financing Program for Different Properties or for Properties They Do Not Own


CASE 1
A charter school leases from an unrelated third party a facility to house a middle school.
The school pays its lease costs with Facility Grant Program funds.
CASE 2
A charter school leases from a closely associated entity a facility to house an elementary school.
The school pays its lease costs with Facility Grant Program funds.
SCHOOL
Through the Conduit Financing Program, an entity closely associated with the school finances the purchase of a separate facility.
SOLD
Through the Conduit Financing Program, the same closely associated entity finances the purchase of an adjacent property to construct a parking lot and expand the school's playground.
P

Source: CSFA documents and official statements.

Finally, our review of five bond issuances found the bond documents listed Facility Grant Program funding—among other public funding sources, such as operational allocations from the State—as a source of revenue for the charter schools associated with the borrower. Because they listed the Facility Grant Program funds among several other sources of revenue, the bond documentation did not directly convey the degree to which the borrowing entities were relying on schools receiving Facility Grant Program funds to be able to repay the bond debt. In total, the Facility Grant Program funds that these entities estimated their associated charter schools would receive was an average of 4 percent of the school's estimated revenue. Nonetheless, the dissolution of the Facility Grant Program or significant changes in its eligibility criteria would cause these schools to become more dependent on other sources of funding—including their operational allocations from the State—to pay rent to the entities that have borrowed funds under the Conduit Financing Program.

State Law Could Be Strengthened to Prevent Negative Impacts From Charter School Closure

Determining the final disposition of a facility after a charter school closes is not straightforward. A charter school may close voluntarily or, if its charter is revoked or not renewed, involuntarily. In either case, the charter school must complete an independent final close-out audit that includes an accounting of all of its assets. However, because a charter school is not always the legal owner of the facility that it occupies—for instance, when it rents or leases a facility from a third party—the close-out audit may not identify the disposition of that property. We attempted to review the close-out audits of 10 charter schools that received funding from the Facility Grant Program from fiscal years 2017–18 through 2020–21 to identify how the facilities they had occupied were used after their closure. One close-out audit was unavailable and of the nine close-out audits we reviewed, none indicated what happened to the facilities. To attempt to determine the use for the facilities, we conducted online research. Table 3 shows the results of our research and indicates how many charter school sites were rented from entities closely related to the schools.

Table 3
Former Charter School Sites Are Currently Used for Various Purposes

CURRENT PURPOSE	NUMBER OF FORMER CHARTER SCHOOL SITES	NUMBER OF SCHOOL SITES WHERE THE SCHOOL WAS RENTING FROM A CLOSELY RELATED ENTITY
Education	4	1
Religious	3	0
Community Health and Services	3	2
Available for Lease or Sale	3	1
Unidentified Purpose	6	2

Source: Online research and CSFA records regarding 10 former charter schools.

Note: The 10 charter schools we reviewed received Facility Grant Program funding and some schools used the funding for multiple school sites resulting in 19 school sites we reviewed.

Although property that housed a charter school may later be used for noneducational purposes, it is not necessarily true that charter schools or CMOs have privately benefited from the sale of those properties. For example, the property may never have been owned by a charter school, CMO, or one of its closely associated entities; it may have been leased instead. In cases where the previous owner was a tax-exempt charter school, CMO, or one of its subsidiaries, state law provides clear protections to prevent private gain. These entities are generally allowed to sell their facilities to any entity provided that they comply with the key requirements in the text box. These protections exist to generally prevent improper private gain from the sale of an asset owned by a tax-exempt educational entity.

Legal Requirements for the Sale of Assets Belonging to Tax-Exempt Educational Entities

- The property must generally be sold for fair market value, which is the highest price on the date of valuation that would be agreed to by a willing seller and buyer, both with full knowledge of the property and neither with an urgent necessity to sell or buy.
- Sale proceeds must generally be used for the advancement of the entity's public purposes.
- No part of the net earnings may inure to the benefit of any private individual.

Source: Federal law, state law, and the Attorney General's *Guide for Charities*.

State law imposes additional safeguards for transactions involving charter school or CMO subsidiaries that are nonprofit public benefit corporations. If the corporation seeks to sell or lease all or substantially all of its corporate assets, state law requires it to provide notice to the Attorney General 20 days before the transaction occurs, subject to certain limited exceptions. Additionally, if the corporation seeks to dissolve, it must obtain a written waiver of objections from the Attorney General regarding the distribution of its assets. The Attorney General reviews and evaluates all relevant information related to the transaction and has the authority to take appropriate steps—such as requesting an independent appraisal to ensure that the assets' sale prices and terms are fair—to determine whether to object to the transaction. The Attorney General is empowered to investigate the transactions of a nonprofit public benefit corporation in order to ensure that those transactions carry out the corporation's public purposes and do not result in improper private gain to any person.

A common occurrence in our review was that charter school or CMO subsidiaries that hold title to facilities were tax-exempt LLCs. State law authorizing the creation of LLCs does not impose the same notice requirements on an LLC that has attained tax-exempt status as it does on a nonprofit public benefit corporation. Thus, a charter school subsidiary that is an LLC may sell or lease a school facility without notifying the Attorney General of the transaction. Although state law grants the Attorney General the authority to investigate transactions involving charitable assets, including those owned by tax-exempt LLCs, we question the effectiveness of this provision if there is no mandate that tax-exempt LLCs notify the Attorney General of these transactions.

Aside from concerns about profits from closures, it remains true that charter school closures can negatively affect students' education. As we describe earlier in this report, charter schools that receive Facility Grant Program funding are less likely to close than other charter schools. Nonetheless, when a charter school closes, families must find new schools for their students to attend. This additional influx of students may contribute to classroom overcrowding in nearby schools, particularly given that evidence indicates Facility Grant Program recipients operate in areas of the State where classroom space is needed.

To mitigate the potential effects of charter school closures in such cases, the Legislature could adopt a framework like the one already in place to safeguard health care infrastructure in California. Similar to when a charter school sells or leases its facilities, state law requires that a nonprofit corporation that operates or controls a health care facility must notify the Attorney General when it intends to sell, lease, or dispose of its assets to a for-profit or mutual benefit entity. However, one notable difference exists. Specifically, during the Attorney General's review of a health care facility sale or lease, it must consider whether the transaction may significantly affect the availability or accessibility of health care services to the affected community and whether the sale is in the public interest. Based on the results of that review, it has the authority to approve, conditionally approve, or deny the sale or lease of the health care facility. Moreover, to serve the public interest, the Attorney General can impose conditions on the transaction. For example, the Attorney General recently approved the sale of a health care facility under the condition that the facility maintain specific health care services and continued participation in Medi-Cal and Medicare for 10 years.

If the Legislature adopted a similar review process for charter school closures, it could focus the requirements on schools that have used Facility Grant Program funding to pay for a portion of their rent or lease costs from closely associated entities. Under such an approach, the Legislature could empower the Attorney General to impose conditions on the sale or lease of property, similar to those it can impose on the sale or lease of health care facilities. For example, the Attorney General could require the continued operation of the property as a nonsectarian public school. Because these new requirements would apply only to charter schools that have used Facility Grant Program funds to pay rent to closely associated entities, they would not infringe on the future use of property owned by other organizations unaffiliated with public education.

Please refer to the section on page 3 to find the recommendations that we have made as a result of these audit findings.

CSFA Does Not Take Adequate Steps to Appropriately Vet Facility Grant Program Applicants

Key Points

- In implementing the Facility Grant Program, CSFA has established a narrow definition of *related parties* that excludes nonprofit CMOs and the subsidiaries of those CMOs and charter schools. As a result, CSFA does not apply the same scrutiny to lease and rental agreements involving these entities as landlords.
- CSFA relies heavily on applicants to the Facility Grant Program self-certifying in two key areas, which may lead it to provide funding to schools that are not eligible.

When Reviewing Facility Grant Program Applications, CSFA Does Not Identify Possible Conflicts of Interest Involving Nonprofit CMOs and Subsidiaries

State law regarding conflicts of interest is generally designed to stop public officials from using their positions to influence governmental decisions or contracts in a manner that has the potential to personally financially benefit them. As we previously describe, state law defines the conditions under which agreements between closely related entities represent self-dealing or a conflict of interest and are therefore prohibited. The text box summarizes the key conflict-of-interest and related-party requirements that apply to charter schools and CMOs.

In addition, CSFA adopted permanent regulations in 2014 to address potential conflicts of interest affecting rent or lease agreements for which the Facility Grant Program provides funds. The regulations define *related parties* to generally include school officials and their close family members, as well as certain corporate entities affiliated with those officials or family members.

Key Conflict-of-Interest Requirements That Apply to Charter Organizations

Government Code section 1090

- Generally prohibits a public official and the board or body of which the official is a member from acting in an official capacity to make contracts in which the official has a financial interest.
- Voids contracts found to be in violation.

Political Reform Act of 1974

- Generally prohibits a public official from making, participating in making, or influencing a governmental decision in which the official has a financial interest.
- Requires financial interest disclosure and a recusal from participation in any decision in which the official has an interest.

CSFA Regulations

- Define *related party* and establish that rental or lease agreements between related parties are not eligible for Facility Grant Program funding unless the parties take specific steps.
- Reinforce the applicability of Government Code section 1090 and the Political Reform Act of 1974.

Source: State law and regulations.

Related Party Requirements

A charter school that has a lease or rental agreement with a related party must satisfy all of the following conditions to be eligible for funding:

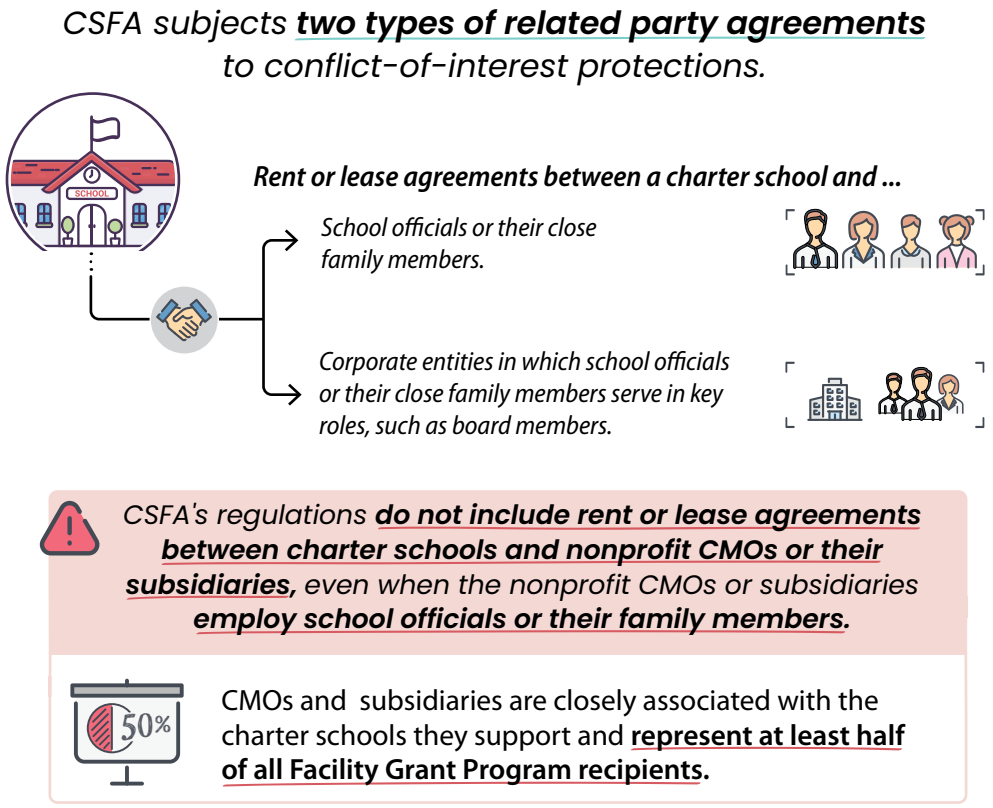
- The related party must abstain from voting or participating in discussions regarding the approval of the lease or rental agreement.
- The related party must abstain from voting or participating in discussions regarding the decision to apply for Facility Grant Program funds to cover costs associated with the lease or rental agreement.
- The related party must abstain from participating in the application for or administration of the charter school's program funds.
- The related party must disclose his or her interest in the lease or rental agreement to the charter school's governing board.
- Either the amount of the lease or rent must be at or below fair market rent based on an independent appraisal, or the governing board must make a finding that the lease or rental agreement is reasonable under the circumstances.
- The related party must abstain from signing the lease or rental agreement on behalf of the charter school.

Source: State regulations.

The regulations also restrict an applicant from using program funds to pay for rent or lease agreements with those parties unless they satisfy certain conditions. The text box lists the conditions.

However, CSFA's definition of *related parties* does not include all closely associated entities that may be involved in a rent or lease agreement, as Figure 11 shows. CSFA's regulations excludes both nonprofit corporate entities and the wholly owned subsidiaries of such entities from the definition of *related parties* as long as the entities were formed for the purpose of managing or providing support to the charter school. In effect, this definition excludes nonprofit CMOs, their subsidiaries, and the subsidiaries of charter schools that are eligible to receive Facility Grant Program funding from being considered related parties. As we describe earlier in this report, charter schools and CMOs may create subsidiary organizations that hold the title to property. As a result of the exclusion in CSFA's regulations, rent or lease agreements between an applicant charter school and its nonprofit CMO or subsidiaries are not subject to the same scrutiny as agreements involving related parties. The explicit exclusion of nonprofit CMOs and subsidiaries from the definition of *related parties* indicates that CSFA considered the relationship between charter schools, their nonprofit CMOs, and subsidiaries and found them not to be a source of concern with respect to conflicts of interest.

Figure 11
CSFA's Definition of Related Parties Is Narrow


CSFA subjects two types of related party agreements to conflict-of-interest protections.
SCHOOL
Rent or lease agreements between a charter school and ...
School officials or their close family members.
Corporate entities in which school officials or their close family members serve in key roles, such as board members.
CSFA's regulations do not include rent or lease agreements between charter schools and nonprofit CMOs or their subsidiaries, even when the nonprofit CMOs or subsidiaries employ school officials or their family members.
50%
CMOs and subsidiaries are closely associated with the charter schools they support and represent at least half of all Facility Grant Program recipients.

Source: CSFA's regulations, Facility Grant Program application data, and CDE's data on charter school types.

When we asked CSFA why it had not included nonprofit CMOs or subsidiaries in its definition of *related parties*, it could not provide a clear explanation. The documents that it did provide, as well as the final regulations, suggest that CSFA was concerned only with identifying and preventing a school official who either individually owns a facility, or owns or controls a business that owns a facility, from improperly benefiting by renting that facility to the charter school. The regulations do not address the conflict of interest that could exist between a Facility Grant Program recipient and a nonprofit CMO or subsidiaries when one or more individuals sit on the boards or are significant managers of both entities.

CSFA's data indicate that a much larger proportion of Facility Grant Program recipients would be *related parties* under an expanded definition. According to CSFA's data, only about 6 percent of Facility Grant Program recipients from fiscal years 2017–18 through 2021–22 had rental or lease agreements with an entity that met CSFA's definition of a *related party* and those entities received about $50 million—or 7 percent of total funding distributed—over the five year period we reviewed. However, application data from CSFA show that a much larger percentage of applicants were in rent or lease agreements with closely associated entities that

do not meet CSFA's definition of a *related party*. Specifically, about one-third of applicants during our audit period indicated that their rent or lease agreement was with an entity to which they had some other relationship—such as that of a CMO or supporting subsidiary. Given the frequency of these types of arrangements, it would be prudent for CSFA to revisit its regulations to include nonprofit CMOs and their subsidiaries within its definition of *related parties*.

Recent updates to state law are also cause for CSFA to revisit its regulations. The Legislature amended state law in 2019 to expressly require charter schools and CMOs to comply with the provisions of Government Code section 1090 and the Political Reform Act of 1974. However, CSFA has not updated its conflict-of-interest regulations since this change to the law. Instead, CSFA has taken a passive approach to ensuring compliance with conflict-of-interest laws, stating that the Fair Political Practices Commission (FPPC) is responsible for enforcing Government Code section 1090, not CSFA. Although we acknowledge the role of the FPPC, we also believe CSFA has a responsibility to identify conflicts of interest and to prevent a charter school or CMO from improperly receiving state funding under the Facility Grant Program when a prohibited conflict exists. Therefore, it would be advisable for CSFA to revise its regulations to ensure its review of applications for Facility Grant Program funding addresses the key ways in which entities might violate either Government Code section 1090 or the Political Reform Act of 1974.

CSFA's Process to Assess Applicants Relies Entirely on Applicants' Self-Certification in Two Key Areas

Despite establishing a process to assess related parties for possible conflicts of interest, CSFA does not review all applicants to the Facility Grant Program for potential conflicts of interest. As we state previously, CSFA's regulations restrict a charter school from using Facility Grant Program funds to pay for rent or lease agreements with a related party unless the related party satisfies certain conditions. To that end, CSFA has established procedures that describe the steps its staff must follow to review any related parties that a charter school reports. Those steps include verifying that the charter school has satisfied all of the relevant conditions in CSFA's regulations. However, CSFA's process relies solely on charter schools self-disclosing any related parties, which increases the risk of the improper use of grant funds.

Specifically, CSFA's procedures direct its staff to identify a charter school as eligible for the Facility Grant Program if the charter school reports no related parties. According to CSFA, if an applicant reports that it has no related party, CSFA takes no further action. CSFA's procedures—updated in January 2022—corroborate this assertion by clearly showing that it does not expect its staff to take any additional steps to identify potential conflicts when a school indicates that the property owner is not a related party.

To assess the risk of relying on an applicant's self-disclosure of a potential conflict of interest, we reviewed 11 applications in which charter schools responded that they had no relationship with their landlord. Using information the school provided in its application and publicly available information, we identified three cases in

which there was a heightened risk that the applicant and the landlord were closely associated despite the charter school not saying so on its application. For example, we found a case in which a charter school was renting from a subsidiary organization that was formed for the purpose of owning and managing property. These cases demonstrate that applicants may not always respond accurately to questions about their relationship to their landlord, and further action by CSFA is warranted.

CSFA could take steps to identify whether it has improperly issued Facility Grant Program funding to charter schools that did not accurately self-disclose a related party. Specifically, CSFA established as part of its regulations the authority for it or the State Controller's Office to conduct audits to ensure that charter schools use program funds consistently with the program's requirements. Regulations further state that recipients may be required to routinely verify continued eligibility. We asked CSFA whether it had ever conducted audits under this authority or whether the State Controller's Office had ever done so. In response, CSFA stated that it was not aware of any audits by the State Controller's Office and that it has periodically conducted additional reviews of Facility Grant Program funding. We recognize that vetting all agreements between charter schools or CMOs and their related parties during application review would likely be a complex task and that doing so might hinder CSFA's ability to efficiently award Facility Grant Program funding. However, CSFA could use its audit authority to review a sample of recipients for potential conflicts of interest on an annual basis.

In addition, CSFA does not perform any verification of applicants' compliance with another key program eligibility requirement—that applicants may not operate as or be operated by for-profit organizations. As we describe in the Introduction, since July 2019, state law has prohibited new charter schools and those seeking charter renewal or revision from either operating as or being operated by a for-profit corporation, a for-profit CMO, or a for-profit educational management organization (EMO). Effective March 2020, CSFA amended its regulations related to the Facility Grant Program to prohibit charter schools from being eligible for the program if they are operating as or being operated by a for-profit corporation, for-profit CMO, or for-profit EMO. During our review of CSFA's Facility Grant Program procedures and processes, we found that CSFA does not take any action during its application review to verify that the applicants are not operating as or by a for-profit organization.

According to CSFA, it relies on applicants to certify that they are in compliance with all program requirements when they apply for Facility Grant Program funding. This is another example of CSFA's deference to applicants' attestations rather than proactive verification of a key program requirement. We reviewed five applicants to which CSFA ultimately awarded Facility Grant Program funding and we confirmed that none of them were operated as or were operated by a for-profit organization. Although none of the applicants we reviewed were examples of program noncompliance, there remains a risk that a for-profit charter school—or a charter school operated by a for-profit organization—received Facility Grant Program funding or may apply for funding in the future because it may have been authorized before the prohibition in state law became effective. Moreover, an applicant operating as a for-profit organization would not be subject to the same requirements under state and federal law with respect to private gain. CSFA should require

applicants to submit proof that they comply with this key program requirement and adopt procedures to review this documentation and verify that applicants are eligible for the program.

Please refer to the section on page 3 to find the recommendations that we have made as a result of these audit findings.

Other Area We Reviewed

The State Lacks Data on the Organizational Types of Charter Schools

Despite CDE's efforts to gather data on the organizational types of charter schools operating in California, charter schools do not always provide clear or complete information. According to its website, CDE provides an opportunity for charter schools to verify and update their information each year through the Charter School Annual Information Update (charter school survey). As part of that survey, CDE asks charter schools to identify their organizational type using the four types the text box lists. We reviewed the results of charter school surveys that CDE conducted during fiscal years 2017–18 through 2021–22 and found that 53 percent of Facility Grant Program recipients had reported they were affiliated with CMOs. CSFA awarded these charter schools nearly $412 million from the Facility Grant Program during the period. However, of the more than 500 charter schools that received funding from the Facility Grant Program over these five years, 27 did not respond to the organizational type question in the charter school survey and 150 reported organizational types that were unclear, such as *other* or *none*. As a result, we cannot determine the type of charter school organizations for 35 percent of Facility Grant Program recipients.

Charter Organizational Types

- **CMO:** A nonprofit organization that operates or manages a network of charter schools (either through a contract or as the charter holder) linked by centralized support, operations, and oversight.
- **Single management (nonprofit):** A nonprofit organization that is not a CMO and that provides management services to one charter school.
- **None:** A charter school that is not operated by an organization that meets the definition of a CMO or single management.
- **Other:** A charter school that is operated by an organization that does not meet the definition of a CMO, single management, or none.

Source: CDE website and staff.

According to CDE's Charter Schools Division, state law does not require the charter school survey; thus, charter schools complete it on a volunteer basis. By establishing state requirements related to the collection of charter school organizational data, the Legislature could enable CSFA to improve its oversight of charter schools. According to the U.S. Department of Education, collecting information about CMOs allows stronger oversight and accountability over federal funds allocated to the schools that work with such organizations.

Please refer to the section on page 3 to find the recommendation that we have made as a result of these audit findings.

We conducted this performance audit in accordance with generally accepted government auditing standards and under the authority vested in the California State Auditor by Government Code section 8543 et seq. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on the audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,

GRANT PARKS
California State Auditor

February 14, 2023

Appendix A

Assessed Value of Charter Schools' Property

The Joint Legislative Audit Committee (Audit Committee) requested that, to the extent possible for recent Facility Grant Program awarding cycles, we identify the amount, percentage, and estimated value of properties acquired by LLCs that are wholly owned by charter schools and CMOs. During fiscal years 2017–18 through 2021–22, more than 500 charter schools received funding from the Facility Grant Program. Generally, as part of the Facility Grant Program, CSFA does not collect information about the estimated value of properties that charter schools rent or information about who is the legal owner of the property that the charter schools rent. Given that significant resources would be needed to perform a comprehensive analysis of the amount, percentage, and estimated value of properties owned by entities closely associated with Facility Grant Program recipients, we reviewed public information about the properties associated with the 10 cases we reviewed in which a charter school and its closely associated entities participated in both the Facility Grant Program and the Conduit Financing Program. Specifically, we used the websites of county assessors and revenue bond documentation to identify the estimated value of properties owned by subsidiaries of charter schools and CMOs. Table A lists the charter school, property address, property purchase month, year, and amount, and the most recently available assessed property value. Table A includes only properties acquired using bonds obtained during our period by the ten entities we reviewed, it does not include properties that were improved using bond funding or cases in which previous acquisitions were refinanced. County assessors are responsible for calculating a property's assessed value in accordance with state law, which limits the annual increase of the assessed value to the lesser of the rate of inflation or 2 percent.

Table A
Charter Schools' Properties Purchase and Assessment Information

SCHOOL	PROPERTY ADDRESS	PURCHASE MONTH AND YEAR	PURCHASE AMOUNT (IN THOUSANDS)	MOST RECENT AVAILABLE ASSESSED VALUE (IN THOUSANDS)
KIPP Pueblo Unido	7801-7835 Otis Ave., Cudahy, 90201	July-19	$4,050	$4,259
KIPP Comienza Community Prep	2218-2220 East Florence Ave., Huntington Park, 90255	September-18	1,330	1,426
KIPP Comienza Community Prep	7300 Roseberry Ave., Huntington Park, 90255	April-17	4,165	12,754
KIPP Academy of Innovation	4250 East Olympic Blvd., Los Angeles, 90023	September-18	865	13,272
KIPP Corazon Academy (Lower School)	2925 Illinois Ave., South Gate, 90280	April-19	460	493
KIPP Corazon Academy (Upper School)	8616-8638 Long Beach Blvd., South Gate, 90280	March-19	3,950	10,768
KIPP Philosophers Academy	10115 Grape St., Los Angeles, 90002	August-18	1,450	1,555
KIPP Compton Community (Lower School)	1240 Airport Way, Compton, 90222	November-18	2,150	1,966

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SCHOOL	PROPERTY ADDRESS	PURCHASE MONTH AND YEAR	PURCHASE AMOUNT (IN THOUSANDS)	MOST RECENT AVAILABLE ASSESSED VALUE (IN THOUSANDS)
Kepler Neighborhood	1440 and 1462 Broadway Street, Fresno, 93721 1449 and 1461 Broadway Street, Fresno, 93721	May-17	3,500	9,438
Animo James B. Taylor Charter Middle	810 and 820 East 111th Place, Los Angeles, 90059 840 East 111th Place, Los Angeles, 90059	January-19	6,900	3,933
Animo Mae Jemison Charter Middle	12700 Avalon Blvd., Los Angeles, 90061	October-18	8,532	9,148
Aspire University Charter School	819 Sunset Ave., Modesto, 95351	December-20	20,096	14,280
Aspire Vanguard College Preparatory Academy				
Aspire Stockton TK-5 Elementary School	1555 and 1605 East March Lane, Stockton, 95210	May-22	5,000	5,000
College Preparatory Middle School	10269 Madrid Way, Spring Valley, 91977	July-20	11,483	11,712
Girls Athletic Leadership School Los Angeles	14203 Valerio Street, Van Nuys, 91405	October-21	2,000	2,040
TEACH Tech Charter High	10616 South Western Avenue, Los Angeles, 90047	January-20	13,050	14,191
TEACH Preparatory Mildred S. Cunningham & Edith H. Morris Elementary	8505 South Western Avenue, Los Angeles, 90047	March-20	6,250	6,570
TEACH Resource Center Facility	10600 S. Western Avenue, Los Angeles, 90047	January-20	900	946

Source: EMMA official statements and information from county assessor websites.

Note: Properties are not always associated with facility grant funds.

Appendix B

Scope and Methodology

The Audit Committee directed the California State Auditor to conduct an audit of CSFA's oversight of the Facility Grant Program and Conduit Financing Program. Table B lists the objectives that the Audit Committee approved and the methods we used to address them.

Table B
Audit Objectives and the Methods Used to Address Them

	AUDIT OBJECTIVE	METHOD
1	Review and evaluate the laws, rules, and regulations significant to the audit objectives.	Reviewed criteria contained within the laws, rules, regulations, policies and procedures significant to the audit objectives.
2	Evaluate whether CSFA appropriately and consistently administers funding for the Facility Grant Program and Conduit Financing Program when selecting recipients in accordance with state law and regulations, including conflict-of-interest laws. In making this determination, assess the following: a. The criteria CSFA staff use to approve or deny Facility Grant Program applications and whether these criteria meet state law and regulations. Evaluate whether these criteria are sufficient in meeting the intent of the law. b. The criteria CSFA staff use to approve or deny Conduit Financing Program applications and whether these criteria meet state law and regulations. Evaluate whether these criteria are sufficient in meeting the intent of the law.	• Compared CSFA policies and procedures for evaluating applications for the Facility Grant Program and Conduit Financing Program with key requirements in state law and regulations and generally found they were consistent other than the issues related to conflict of interest and operation by for-profit organizations in the Facility Grant Program. We reviewed state law and bill analyses to determine whether the criteria CSFA uses to evaluate applicants are consistent with the intent of the law. • Selected six applications to the Facility Grant Program over fiscal years 2017–18 through 2021–22 and determined that the CSFA appropriately and consistently evaluated applicants' eligibility except in the case of the conflict-of-interest review and operation by a for-profit, as noted above. • Selected five applications to the Conduit Financing Program from 2017 through 2022 and determined that CSFA appropriately and consistently facilitated the issuance of conduit revenue bond transactions.
3	To the extent possible, identify the following for recent Facility Grant Program awarding cycles:	
	a. The number and percentage of recipients that receive funding from the Facility Grant Program based on their physical location in an area of a public elementary school of which at least 55 percent of pupil enrollment is eligible for FRPM.	Using CSFA data for fiscal years 2017–18 through 2021–22, summarized the number and percentage of charter schools that were eligible for Facility Grant Program funds based on their own enrollment of at least 55 percent of students eligible for FRPM or their physical location in an area of a public elementary school that had an enrollment that was at least 55 percent FRPM-eligible. We used CDE data to determine the percentage of enrollment of FRPM-eligible students at those charter schools.
	b. The amount and percentage of Facility Grant Program funds allocated to charter schools that rented or leased a school site from a related party.	• Reviewed CSFA data to determine the amount and percentage of Facility Grant Program funds allocated during fiscal years 2017–18 through 2021–22 to charter schools that had rent or lease agreements involving related parties. • Selected 11 charter school applicants during fiscal years 2017–18 through 2021–22 that self-certified as not having related party agreements and conducted internet research and reviewed supporting documentation from CSFA to determine whether any had potential conflicts of interest.
	c. The amount, percentage, and estimated value of properties acquired by LLCs wholly owned by charter schools and CMOs.	Determined that significant resources would be needed to perform a comprehensive analysis of the amount, percentage, and a value of properties owned by entities closely associated with Facility Grant Program recipients. Accordingly, we reviewed properties associated with our selection under Objective 6. We analyzed audited financial statements, tax reports, county assessor reports, and other relevant documentation to determine the most recent sale value.

continued on next page . . .

	AUDIT OBJECTIVE	METHOD
	d. The amount and percentage of Facility Grant Program recipients whose school site is in an area where OPSC has determined there is no need for additional classroom space.	Determined that there is no comprehensive and up-to-date source of data for where there is a need for additional classroom space. Accordingly, we addressed this objective by selecting 19 cases in which a charter school received Facility Grant Program funding and OPSC data existed about classroom space needs. We then used those 19 cases to determine the need for additional classroom space in the school districts where the charter schools are located.
	e. The amount and percentage of Conduit Financing Program recipients that also receive Facility Grant Program funds.	Reviewed official statements to identify the entities that participated in the Conduit Financing Program during fiscal years 2017–18 through 2021–22 and also the charter schools with which those entities were closely linked. Reviewed CSFA Facility Grant Program award information to determine which charter schools received program funding during the same period. Compared these two analyses to determine which charter schools benefited from both programs.
	f. The amount and percentage of Facility Grant Program recipients affiliated with CMOs or national charter chains.	For fiscal years 2017–18 through 2021–22, analyzed CDE charter school data and CSFA Facility Grant Program recipient data to determine the amount and percentage of Facility Grant Program recipients affiliated with CMOs or national charter chains. Comprehensive information on which recipients were affiliated with charter organizations with a national presence was not available.
	g. The amount and percentage of applicants to the Facility Grant Program that have been denied funding.	For fiscal years 2017–18 through 2021–22, summarized the number of ineligible applicants for the Facility Grant Program and the reasons they were ineligible, based on data provided by CSFA.
4	Determine which charter schools or CMOs have received the most funding from the Facility Grant Program and from the Conduit Financing Program.	Obtained data from CSFA on the amount of funds it awarded to charter schools through the Facility Grant Program and amount of bonds issued through the Conduit Financing Program during fiscal years 2017–18 through 2021–22. We used EMMA revenue bond reports and CSFA data on the Facility Grant Program to calculate the amount each charter school or CMO received from both programs. We have also identified the charter schools that received the most amount of funding from the Facility Grant Program and the entities that benefited from the most funds from revenue bonds under the Conduit Financing Program from fiscal years 2017–18 through 2021–22.
5	To the extent possible, determine how properties owned by LLC subsidiaries that receive Facility Grant Program funds are used after the charter school occupying the facility has closed.	• Because information about subsidiary property ownership is not available through the Facility Grant Program, we attempted to use information about charter schools that benefited from both the Facility Grant Program and the Conduit Financing Program (which has more available information about property ownership). We reviewed CSFA and CDE data to identify charter schools that benefited from both programs and subsequently closed during fiscal years 2017–18 through 2021–22. No schools that benefited from both programs during the period subsequently closed. Therefore, we reviewed a judgmental selection of 10 charter schools that received Facility Grant Program funding and closed during the period. We then reviewed close-out audits and information available online to determine how the properties were used after the charter schools closed. • Using CDE data for the number of charter schools and charter school closures from fiscal years 2017–18 through 2021–22, determined the rate of closures for Facility Grant Program recipients compared to the rate for other charter schools.
6	Evaluate the interaction between the Facility Grant Program and the Conduit Financing Program, and assess whether the programs are at risk of wasteful spending or unlawful or improper activities.	• Selected five charter schools and five CMOs that benefited from both the Conduit Financing Program and Facility Grant Program during fiscal years 2017–18 through 2021–22. We reviewed relevant documentation and interviewed CSFA staff to determine all bonds issued; the bond amounts; all charter schools associated with each bond; each charter school's project allocation amount, rationale, and appropriateness; and each charter school's Facility Grant Program fund amount. • Reviewed federal and state law and regulations, CSFA documents, charter school studies, case law, and legal articles to determine whether charter school entities engaging in both programs are at risk of wasteful spending or unlawful or improper activities.

	AUDIT OBJECTIVE	METHOD
7	To the extent possible, determine how dissolution of the Facility Grant Program would affect charter schools and their ability to repay CSFA-issued conduit revenue bonds. Identify any implications to the State's credit rating if charter schools are unable to repay CSFA-issued conduit revenue bonds.	• Using enrollment data from CDE, calculated per-pupil spending for charter schools that received funding from the Facility Grant Program for fiscal years 2017–18 through 2021–22. We assessed the impact of the Facility Grant Program on charter schools that received program funding based on relative school size. • Reviewed bond documents and criteria used by credit rating agencies to identify any potential impact of charter schools defaulting on conduit revenue bonds on the State's credit rating. • For five Conduit Financing Program applicants, reviewed supporting documentation to determine the extent to which they planned to rely on funding from the Facility Grant Program to repay their bonds.
8	Review and assess any other issues that are significant to the audit.	No other issues noted.

Source: Audit workpapers.

Data Reliability Assessment

The U.S. Government Accountability Office, whose standards we are statutorily obligated to follow, requires us to assess the sufficiency and appropriateness of computer-processed information that we use to support our findings, conclusions, or recommendations. In performing this audit, we relied on various data sources. From CSFA we relied on spreadsheets of information CSFA used to determine eligibility and the award amount for the Facility Grant Program, spreadsheets CSFA uses to track the progress of its application review, and spreadsheets that listed the conduit revenue bond transactions during our audit period. We relied on these data to select items to review and complete the work described in Table B. To assess these data, we reviewed available information about the data and generally reviewed its accuracy and completeness. We determined that the data on the Facility Grant Program and Conduit Financing Program were sufficiently reliable for the purposes of our audit. We also relied on information from CDE, such as data related to the FRPM enrollment of schools, the closure status of schools, or charter school survey data. We used these data to complete the work described in Table B. The scope of our audit did not extend to CDE, and therefore, its data were of undetermined reliability for the purposes of our audit. Finally, we used data from OPSC related to classroom space needs to perform the work described in Table B. We reviewed available information about the data. We concluded that the data were of undetermined reliability for the purposes of our audit. Although these determinations may affect the precision of some of the information, there is sufficient evidence in total to support our findings, conclusions, and recommendations.

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January 27, 2023

Grant Parks, State Auditor*
California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

RE: Response to Audit 2022-110-STO

Dear Mr. Parks:

Enclosed is the California School Finance Authority's (Authority) response to the California State Auditor's (Auditor) performance audit of the Charter School Facility Grant Program (SB740 Program) and the Conduit Financing Program. After seven months of working with the Auditor's team, the Authority is pleased to note that there were no significant findings regarding the Authority's administration of the SB740 Program or the Conduit Financing Program. We are equally pleased with the finding of concurrence that schools accessing both programs in tandem is in alignment with state law. Lastly, the Auditor acknowledges that these programs administered by the Authority do in fact serve a public good, mitigate school closures, and are providing needed classroom space, primarily in the state's neediest communities. ①

The Auditor identified areas for improvement in the Authority's review processes and provided suggested refinements, as well as potential issue areas to the programs for the Legislature to consider. The Authority is confident that ongoing, institutional best practices, when paired with implementation of the audit recommendations, will enable the Authority to continue to manage these vital programs in the most responsible and transparent way possible. The attached provides an overview of the Authority's remarks on the report and the Auditor's recommendations.

As reflected in the Auditor's findings, the SB740 Program is critically important to the well-being of California's under-served students and families. The Authority is committed to implementing the Auditor's recommendations to the best of its ability, with its existing limited resources. To ensure that any new changes are implemented properly and in a timely manner, the Authority will need additional personnel and resources to carry out these program modifications that will be required to fulfill any new statutory obligations. ②

* California State Auditor's comments appear on page 47.

The Authority thanks the Auditor's team for their diligence over the course of several months and the insights provided. We look forward to continuing to serve the well-being of California's youngest and most vulnerable.

Regards,

Katrina Marie Johantgen (electronic signature)

Katrina M. Johantgen
Executive Director

California School Finance Authority
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January 27, 2023
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Findings and Benefits

- The Charter School Facility Grant Program (SB740 Program) is generally fulfilling its purpose of providing support to charter schools that serve students from low-income households.
    - Funding from the SB740 Program provides significant financial support to participating charter schools that would otherwise need to use a substantive percentage of their operational funding on facility costs instead of direct education of students.
    - Charter schools that receive SB740 Program funding are less likely to close, whereas charter schools that did not receive program funding are almost twice as likely to close.
    - Participation in the SB740 Program appears to be associated with charter school stability, as an average of 2,700 fewer charter school students experienced school closures each year during the audit period. (3)
    - Twelve of the 20 SB740 Program recipients reviewed were operating in areas where the State has identified a need for more classroom space.* Therefore, the program is assisting the State in meeting identified classroom space needs.
- Charter schools benefiting from both the SB740 Program, and the Conduit Financing Program, do not violate state law.

As there were no findings related to the Conduit Financing Program within the Authority's purview, we have provided our feedback on the Auditor's findings and recommended changes to the SB740 Program.

Charter School Facility Grant Program (SB740 Program): Enacted in 2001, the SB740 Program provides rent and lease assistance to charter schools that meet certain eligibility criteria. Since 2013, the Authority has been charged with the administration of the SB740 Program. We are pleased that the Auditor reached the above referenced conclusions regarding the program. The Authority's remarks related to the recommendations are listed below.

* CSFA's reference to *20 SB740 Program recipients reviewed* is based on its response to the draft of our original report. We subsequently adjusted the number of Facility Grant Program recipients to 19 recipients in this reissued report.

Recommendations

- The Auditor recommends that the Authority work with stakeholders to amend the SB740 Program's regulations and process for vetting conflict-of-interest to include all applicants including Charter Management Organizations (CMO) and subsidiaries. The Auditor further recommends that the Authority collaborate with the Fair Political Practices Commission (FPPC) to ensure these changes address all conflict-of-interests laws and government codes. ***The Authority will examine, with the support of the FPPC, changes to the program regulations regarding related parties to ensure consistency with state law. We will bring any recommendations to our board and the Office of Administrative Law for review and consideration.***
- The Auditor recommends that to ensure applicants are appropriately disclosing information about related parties, the Auditor suggests that the Authority annually review a sample of applicants to verify that charter schools accurately reported their lessors are not related under program regulations. ***The Authority will consider the following: 1) implementation of an annual review of a sample of five percent of all applications during each funding round period to determine whether charter schools violate state law; or 2) working with the State Controller's (SCO) K-12 Audit Guide team to integrate the SB740 Program into the audit guide. The incorporation of the SB740 Program into the audit guide will allow charter schools, their authorizers, the SCO, and auditors to ensure compliance with all SB740 program requirements. <u>These additional vetting processes cannot be enacted without augmented staffing levels.</u>*** ②
- To ensure that for-profit charter schools are not receiving grant funds, the Auditor suggests that the Authority require applicants to provide documentation demonstrating the applicant's non-profit status. Staff will evaluate schools' articles of incorporation and verify this information using the Secretary of State's website. ***The Authority will explore this recommendation for adoption but highlights that additional vetting processes will necessitate more staffing resources. It's important to highlight that, since 2019, for-profit charter schools are prohibited from operating in California. As charters expire, and for-profit charters no longer operate in the state, the need for this vetting will terminate in 2026.*** ②

Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE CALIFORNIA SCHOOL FINANCE AUTHORITY

To provide clarity and perspective, we are commenting on the response to the audit from CSFA. The numbers below correspond to the numbers we have placed in the margin of the response.

We do not agree with CSFA's assertion that our audit report contains no significant findings regarding its administration of the Facility Grant Program. We describe in the section starting on page 29 that CSFA does not identify possible conflicts of interest involving nonprofit CMOs and subsidiaries. Further, on page 32 we begin our discussion of CSFA's heavy reliance on applicants' self-certifications of related parties and nonprofit status. The two deficiencies we identified are significant because they may lead the CSFA to provide funding to schools that are not eligible. Therefore we made recommendations to address the weaknesses in its program administration. (1)

As we note beginning on page 32 of the report, CSFA relies entirely on self-certifications from charter school applicants regarding related parties and nonprofit status when evaluating eligibility under the Facility Grant Program. CSFA administers the program and has established regulations governing its operation, and therefore has a responsibility for determining the staffing resources necessary for enforcing its own rules. Given the $142 million distributed in fiscal year 2021–22, relying on an applicant's self-certification is not an effective control. Further, CSFA did not express concerns about its ability to implement our three recommendations with existing personnel and resources when we discussed them in advance of its formal response to our draft audit report. (2)

During our quality control process and subsequent to CSFA's review of the draft report, we adjusted our estimate of the average number of charter school students who would experience a school closure each year during the audit period from 2,700 fewer students experiencing a school closure to 1,900 fewer students, as we indicate on page 18. Nonetheless, we stand by our conclusion that the Facility Grant Program appears to be associated with charter school stability. (3)